LLOYD'S

Solvency and Financial Condition Report

31 December 2016

Lloyd's Solvency and Financial Condition Report – 31 December 2016

Overview

Lloyd's Solvency and Financial Condition Report (SFCR) as at 31 December 2016 has been prepared in accordance with Article 51 of the Solvency II Directive (2009/138/EC), Articles 290 to 298 of the Commission Delegated Regulation (EU) 2015/35, and Section 3 of the PRA Rulebook Solvency II Firms: Reporting Instrument 2015.

This SFCR is prepared in respect of 'the association of underwriters known as Lloyd's' ('Lloyd's), the supervised undertaking as referred to in Annex III of Directive 2009/138/EC. Further information on the structure of Lloyd's, and the basis of preparation of the SFCR, is described in the Summary.

Lloyd's SFCR contains the narrative disclosures necessary to comply with Articles 291 to 298 of the Commission Delegated Regulation (EU) 2015/35, and the quantitative templates as specified by the Commission Delegated Regulation (EU) 2015/2452.

Further information

Additional information regarding Lloyd's may be found within Lloyd's Annual Report 2016 (see link) and Aggregate Accounts 2016 (see link).

The Lloyd's Annual Report includes the Pro Forma Financial Statements (PFFS), which are prepared so that the financial results of Lloyd's and its members taken together and their net assets can be compared as closely as possible with general insurance companies. The Annual Report also includes the accounts of the Society of Lloyd's, comprising the financial position of the Corporation of Lloyd's and Central Fund.

The Aggregate Accounts set out an aggregation of all syndicate annual reports including the audited results for calendar year 2016 and the financial position as at 31 December 2016 of all syndicates which transacted business during 2016.

Where relevant, references to these documents are made in the SFCR.

Governing body's statement in respect of the SFCR

We, Lloyd's Franchise Board, acknowledge our responsibility for preparing the SFCR of Lloyd's as at 31 December 2016 in all material respects in accordance with the PRA Rules and Solvency II Regulations as applicable to Lloyd's.

We are satisfied that:

a) throughout the financial year in question, Lloyd's has complied in all material respects with the requirements of the PRA Rules and the Solvency II Regulations as applicable to Lloyd's; and

b) it is reasonable to believe that Lloyd's has continued so to comply and will continue so to comply in future.

For and on behalf on the Franchise Board

Inga Beale

______________________________ Inga Beale, Chief Executive Officer

______________________________ John Parry, Chief Financial Officer

19 May 2017

Contents

Section	Content	Page
	Summary	6
A	**Business and performance**	13
A.1	- Business	13
A.2	- Underwriting performance	14
A.3	- Investment performance	15
A.4	- Performance of other activities	16
A.5	- Any other information	17
B	**System of governance**	18
B.1	- General information on the system of governance	18
B.2	- Fit and proper requirements	25
B.3	- Risk management system including the own risk and solvency assessment	27
B.4	- Internal control system	31
B.5	- Internal audit function	32
B.6	- Actuarial function	33
B.7	- Outsourcing	34
B.8	- Any other information	35
C	**Risk profile**	37
C.1	- Underwriting risk	38
C.2	- Market risk	40
C.3	- Credit risk	41
C.4	- Liquidity risk	41
C.5	- Operational risk	42
C.6	- Other material risks	42
C.7	- Any other information	44
D	**Valuation for solvency purposes**	46
D.1	Assets	47
D.2	Technical provisions	49
D.3	Other liabilities	53
D.4	Alternative methods for valuation	54
D.5	Any other information	55
E	**Capital management**	56
E.1	Own funds	56
E.2	Solvency Capital Requirement and Minimum Capital Requirement	65
E.3	Use of the duration-based equity risk sub-module in the calculation of the Solvency Capital Requirement	66
E.4	Differences between the standard formula and any internal model used	67
E.5	Non-compliance with the Minimum Capital Requirement and non-compliance with the Solvency Capital Requirement	72
E.6	Any other information	72
Appendix 1	**Quantitative reporting templates**	
Appendix 2	**Report by PricewaterhouseCoopers LLP**	

Summary

What Lloyd's is

Lloyd's is not an insurance company. It is a market of competing syndicates, backed by a strong and unique capital base, which focuses on the underwriting of specialist global property, casualty and reinsurance risks.

The business written at Lloyd's is brought to specialist syndicates, who price and underwrite risk, via brokers and coverholders.

Under its globally recognised name, Lloyd's acts as the market's custodian and is backed by diverse global resources and a capital structure designed to ensure financial security. Lloyd's works with an international distribution network to increase the use of insurance globally.

Led by expert brokers and underwriters operating in more than 200 territories, the Lloyd's market develops and distributes complex and critical insurance to help underwrite human progress.

With expertise earned over centuries, Lloyd's is an influential force in the insurance industry. Its Vision 2025 strategy, launched in 2012, is aimed at ensuring that it remains a global centre for specialist insurance and reinsurance, facing future challenges head-on while grasping the opportunities of a fast-changing world.

Lloyd's Market Structure

Members – providing the capital

The capital to underwrite policies is provided by members of Lloyd's. This capital is backed by many of the world's major insurance groups, listed companies, individuals and limited partnerships, with corporate groups providing the majority of the capital for the Lloyd's market.

Syndicates – writing the insurance

A Lloyd's syndicate is formed by one or more members joining together to provide capital and accept insurance risks. Most syndicates write a range of classes of business but many will have areas of specific expertise. Syndicates are, technically, set up on an annual basis. In practice, they usually operate from year to year with members having the right, but not the obligation, to participate in syndicates the following year. This continuity of capital backing the syndicates means they function like permanent insurance operations. Each syndicate sets its own appetite for risk, develops a business plan, arranges its reinsurance protection and manages its exposures and claims.

At 31 December 2016 there were 99 syndicates at Lloyd's.

Managing agents – managing the syndicates

A managing agent is a company set up to manage one or more syndicates on behalf of the members. Managing agents have responsibility for employing underwriters, overseeing their underwriting and managing the infrastructure and day-to-day operations.

At 31 December 2016 there were 57 managing agents at Lloyd's.

Policyholders – transferring risk
Policyholders include businesses, organisations, other insurers and individuals from around the world who seek to mitigate the impact of potential risks. Policyholders may access the Lloyd's market via a broker, coverholder or service company.

Brokers – distributing business
Lloyd's is a broker market in which strong relationships, backed by deep expertise, play a crucial part. Brokers facilitate the risk transfer process between policyholders and underwriters. Much of this business involves face to face negotiations between brokers and underwriters.

At 31 December 2016 there were 258 brokers at Lloyd's.

Coverholders and service companies – offering local access to Lloyd's
A managing agent may also authorise third parties to accept insurance risks directly on behalf of its syndicates. These businesses, known as coverholders, form a vital distribution channel, offering a local route to Lloyd's in many territories around the world.

At 31 December 2016 there were 3,859 approved coverholder office locations.

A service company operates like a coverholder but is a wholly owned subsidiary of a managing agent or its group. Unlike a coverholder, a service company is able to sub-delegate underwriting authority to other coverholders.

At 31 December 2016 there were 380 service companies at Lloyd's, with the majority in the UK and the US.

Members' agents – supporting the members
Members' agents provide advice and administrative services to members, including assisting with syndicate selection.

At 31 December 2016, there were four members' agents at Lloyd's.

Corporation of Lloyd's – supporting the market
The Corporation oversees the Lloyd's market. It provides the market's infrastructure, including services to support its efficient running, and protects and maintains its reputation.

The Corporation's role includes:

- managing and protecting Lloyd's network of international licences;
- agreeing syndicates' business plans and evaluating performance against those plans. Syndicates are required to underwrite only in accordance with their agreed business plans. If they fail to do so, Lloyd's can take a range of actions including, as a last resort, stopping a syndicate underwriting;
- monitoring syndicates' compliance with Lloyd's minimum standards; and
- continuing to raise standards and improve performance across two main areas:
    - overall risk and performance management of the market; and
    - maintaining and developing the market's attractiveness to capital providers, distributors and clients, while preserving its diversity.

The Corporation's Executive Committee exercises the day-to-day powers and functions of the Council of Lloyd's and the Franchise Board.

At 31 December 2016 the Corporation and its subsidiaries had 1,062 staff.

Financial highlights
Lloyd's made a profit of £2,107m in 2016 based on gross written premium of £29,862m for the year, summarised as follows:

	2016	2015
	£m	£m
Underwriting result (before reallocation of investment return)	468	2,047
Investment return	1,345	402
Profit/(loss) on exchange	578	(70)
Other income	77	56
Expenses (other than operating expenses)	(361)	(313)
Total	**2,107**	**2,122**

The Lloyd's market achieved a pre-tax profit of £2,107m in 2016 (2015: £2,122m) and a combined ratio of 97.9% (2015: 90.0%), which represents a return on capital of 8.1% (2015: 9.1%).

The underwriting result has deteriorated while investment return has improved positively. Foreign exchange gains have also contributed.

On an accident year basis, market conditions in 2016 remained challenging, with a reported deterioration in underwriting performance.

The underwriting result continued to benefit from prior year releases, which accounted for £1,150m (2015: £1,621m), reducing the combined ratio by 5.1% (2015: 7.9%).

The level of release is lower than in recent years but is supported by the strong level of claims reserves. The reserving methodology for setting initial loss estimates varies between syndicates. There are a significant number that reserve prudently, which contributes to the observed trend of relatively high accident year ratios, which reduce over time as they book releases from reserves.

As at 31 December 2016, Lloyd's net total resources – capital, reserves and subordinated loan notes – amounted to £28,597m (31 December 2015: £25,098m). Lloyd's ratings remain at A+ (strong) with Standard and Poor's, AA- (very strong) with Fitch Ratings, and A (excellent) with A.M. Best.

Lloyd's risk profile
At Lloyd's, the risk profile originates from both syndicates and at central level.

Syndicates are the source of the majority of risks. They source all of the insurance business; manage the bulk of the asset portfolios; hold the majority of the counterparty exposures; and conduct most of the day-to-day operational activity. The syndicate risks include: insurance risk (underwriting, reserving and catastrophe risk); market risk on central assets; market risk on syndicate assets (including credit risk on Premiums Trust Funds (PTF)); reinsurance and other credit risk; and syndicate operational risk.

At the central level, additional risks arise from central operational risk and pension fund risk.

Solvency Capital Requirement (Solvency II basis)

The Solvency Capital Requirement (SCR) represents the amount of capital required to withstand a 1 in 200 year loss event over a one year time horizon. Given Lloyd’s unique structure there are two SCRs which are monitored under the Solvency II regime:

- The Lloyd’s market wide SCR (MWSCR) is calculated to cover all of the risks of ‘the association of underwriters known as Lloyd’s’, i.e. those arising on syndicate activity, members’ capital provided at Lloyd’s and the Society taken together, at a 99.5% confidence level over a one year time horizon as provided for in Solvency II legislation. All of the capital of the component parts of the market taken together are available to meet the MWSCR.

- The Lloyd’s central SCR (CSCR) is calculated in respect of only the risks facing the Society and the Central Fund at the same confidence level and time horizon used to calculate the MWSCR. The material risk is that members do not have sufficient funds to meet their underwriting losses even having complied with Lloyd’s rigorous capital setting rules.

Individual syndicates are also required to calculate a SCR, at a 99.5% confidence level over a one year horizon, for each underwriting year; this drives the determination of member level SCRs. Each member’s SCR is derived as the sum of the member’s share of the syndicate’s one year SCR. Where a member participates on more than one syndicate, a credit for diversification is provided to reflect the spread of risk. The MWSCR and CSCR are derived from the Lloyd’s Internal Model which has been approved by the PRA. Individual syndicates also derive SCRs from their own internal models which are subject to approval by the Lloyd’s Capital and Planning Group. The appropriateness of each syndicate’s internal model, including changes thereto and the reasonableness of the key assumptions are assessed as part of the Corporation’s oversight of the Lloyd’s market.

Lloyd’s Internal Model

The approved Lloyd’s Internal Model (LIM) is a purpose built model designed to calculate the MWSCR and CSCR as required under Solvency II. It covers all risk types and all material risks for the aggregation of syndicates as well as for the Corporation, allowing for the unique capital structure of Lloyd’s. The LIM consists of three main components: the Lloyd’s Investment Risk Model (LIRM) which simulates economic variables and total assets returns; the Lloyd’s Catastrophe Model (LCM) which models catastrophe risk using syndicates’ views of risk; and the Capital Calculation Kernel (CCK) which is the main element of the LIM where all other risks are simulated and all risks are combined.

Syndicates calculate their own SCR however the market wide and central capital requirements are derived from Lloyd’s parameterisation at a whole market level to build a view of total market capital requirements from the ground up using market level assumptions. The LIM uses a methodology whereby losses from insurance and other risks are simulated by class of business, allocated to syndicates and through to members to assess the level of capital required by the market and centrally to meet 1 in 200 year losses over the one year time horizon.

Lloyd's solvency ratios and capital

Lloyd's solvency position is summarised below:

	Dec 2016	Dec 2015
	£m	£m
Market wide solvency		
Lloyd's MWSCR	17,200	14,150
Eligible capital	24,764	20,662
Lloyd's solvency ratio	144%	146%
Central solvency		
Central SCR	1,600	1,450
Eligible central capital	3,433	3,162
Lloyd's central solvency ratio	215%	218%

The market wide solvency ratio has moved from 146% at 31 December 2015 to 144% as at 31 December 2016. Even though the SCR has increased significantly from £14,150m at 31 December 2015 to £17,200m as at 31 December 2016, the solvency ratio has remained relatively stable. This is because total eligible own funds have increased from £20,662m at 1 January 2016 to £24,764m at 31 December 2016. The SCR has increased primarily due to an increase in the sterling value of US dollar denominated elements of the SCR; the eligible own funds has increased largely due to an increase in FAL arising from increased member level capital requirements for 2017 compared with 2016.

A summary of Lloyd's capital ('own funds') by tier is set out below.

	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Syndicate assets	2,269			2,269
Members' funds at Lloyd's (FAL)	11,745	9,957		21,702
Society assets:				
Subordinated debt	398	535		933
Deferred tax			40	40
Balance of net assets	1,752			1,752
Total own funds available to meet the SCR	**16,164**	**10,492**	**40**	**26,696**
Lloyd's MWSCR				**17,200**
'Excess' own funds not eligible to meet SCR	-	1,892	40	1,932
Total own funds eligible to meet the SCR	**16,164**	**8,600**	**-**	**24,764**
Lloyd's solvency ratio				**144%**

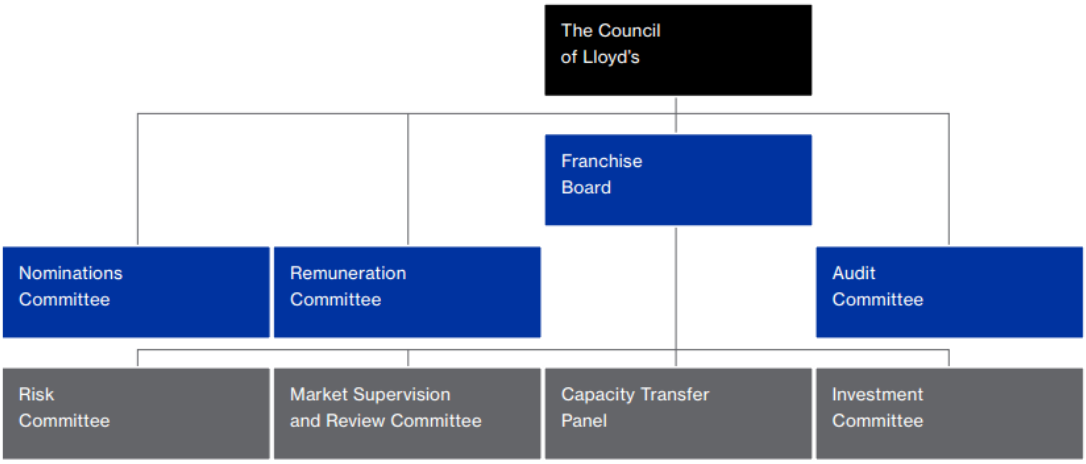
The eligibility of assets to count towards the solvency coverage is subject to tiering restrictions. All Tier 1 assets count fully towards the solvency coverage assessment. However, Tier 2 and Tier 3 assets may only count up to a maximum of 50% of the SCR. A significant portion of the members' FAL are in the form of letters of credit (LOCs) which are classified as Tier 2 assets under Solvency II. This constitutes £1,892m of the 'excess' own funds in accordance with the solvency calculation. These LOCs are callable on demand and when called, the proceeds, namely cash, would qualify as Tier 1 assets. Under these circumstances, the amounts previously restricted would become fully eligible.

The central own funds available to cover the central SCR are summarised below:

	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Society assets: Subordinated debt Deferred tax Balance of net assets Callable layer	 398 1,752 708	 535 	 40 	 933 40 1,752 708
Total central own funds available to meet the central SCR	**2,858**	**535**	**40**	**3,433**
Central SCR				**1,600**
Total central own funds eligible to meet the SCR	**2,858**	**535**	**40**	**3,433**
Central solvency ratio				**215%**

Callable layer
The Society has the right to make a call on members of up to 3% of members' premium limits ("callable contributions"). The callable contributions can be drawn from members' premiums trust funds without the members' consent. This would result in the transfer of Tier 1 capital from syndicate funds to central resources. The value assigned to the callable layer has been reduced to reflect that part of the callable layer which would not be available in a stressed situation at the central SCR level of confidence.

Lloyd's governance structure
The structure of the principal governing bodies of Lloyd's is summarised in the chart below**:**



The Council of Lloyd's
Under Lloyd's Act 1982, the Council of Lloyd's undertakes the management and superintendence of the affairs of the Society and the power to regulate and direct the business of insurance at Lloyd's.

The Franchise Board

The Council established the Franchise Board as from 1 January 2003 and set it a goal: “To create and maintain a commercial environment at Lloyd’s in which the long-term return to all capital providers is maximised”.

The Franchise Board is responsible for the day-to-day oversight of Lloyd’s and thus constitutes Lloyd’s Administrative, Management or Supervisory Body (AMSB).

Basis of preparation of the SFCR

The basis of preparation of the Lloyd’s SFCR has been selected so that the financial position of Lloyd’s is presented on a basis to most appropriately reflect the structure of Lloyd’s.

The SFCR includes the aggregate of returns submitted from syndicates (the relevant ‘Lloyd’s templates’ as referred to in the PRA Rulebook Solvency II Firms: Reporting Instrument 2015’ (PRA 2015/23)), members’ Funds at Lloyd’s (FAL) and in respect of the Society of Lloyd’s, including the Corporation and Central Fund.

The Lloyd’s templates report the Pillar 3 information for calendar year 2016 and the financial position at 31 December 2016 for all syndicates which transacted business during the year. The data therein which contributes to the audited section of the SFCR is the subject of an audit opinion by the auditor of each syndicate.

The capital provided by members is generally held centrally as FAL. The data included within the SFCR in relation to FAL is provided by the Corporation. The data therein which contributes to the audited section of the SFCR is the subject of a reasonable assurance by PwC as the auditor of Lloyd’s.

Data in respect of the Society of Lloyd’s is also provided by the Corporation. Again, the data therein which contributes to the audited section of the SFCR is the subject of a reasonable assurance by PwC.

The balance sheet (S.02.01) and summary of own funds (S.23.01) in the SFCR aggregate the assets held at syndicate level, members’ assets held as FAL and the central resources of the Society. Overall, the SFCR aggregate the results and resources of the Society and its members. The SFCR may, therefore, be used as a reasonable presentation of the results and state of affairs of the Lloyd’s market on a basis that is as closely as possible comparable with general insurance companies.

A. Business and Performance

A.1 Business

Name and legal form of undertaking
Lloyd's is a society incorporated by the Lloyd's Act 1871, whose principal place of business is at One Lime Street, London EC3M 7HA.

The 'association of underwriters known as Lloyd's' is the legal form of the undertaking as defined in Annex III of the Solvency II Directive (2009/138/EC).

Supervisory authority responsible for financial supervision
The supervisory authority of Lloyd's is the Prudential Regulation Authority (PRA), which was created as part of the Bank of England by the Financial Services Act (2012). The registered office of the PRA is as follows:

Prudential Regulation Authority
8 Lothbury
London
EC2R 7HH

External auditor of the undertaking
The independent auditors of Lloyd's are:
PricewaterhouseCoopers LLP
Chartered Accountants
7 More London Riverside
London
SE1 2RT

Holders of qualifying holdings of the undertaking
There are no qualifying holdings applicable to Lloyd's.

Legal structure of group
Lloyd's does not belong to a group.

Material lines of business and geographical areas
Lloyd's writes a wide range of classes of business in a variety of geographical areas. This is highlighted in the below table which provides a Lloyd's class breakdown of gross written premium by region:

	US and Canada	Other Americas	United Kingdom	Rest of Europe	Central Asia & Asia Pacific	Rest of the World	**Total for all Regions**
Reinsurance	22%	70%	28%	29%	46%	62%	**31%**
Property	35%	8%	26%	20%	14%	11%	**27%**
Casualty	26%	10%	25%	22%	28%	10%	**24%**
Marine	7%	7%	6%	18%	7%	6%	**8%**
Energy	5%	2%	2%	4%	2%	2%	**4%**
Motor	3%	1%	11%	3%	1%	5%	**4%**
Aviation	2%	2%	2%	4%	2%	4%	**2%**
Total GWP	**50%**	**7%**	**15%**	**14%**	**10%**	**4%**	**100%**

Significant events during the reporting period

The United Kingdom voted, in the referendum of 23 June 2016, to leave the European Union (EU) ('Brexit'). This was subsequently confirmed by the European Union (Notification of Withdrawal) Act 2017 which received Royal Assent Act on 16 March 2017, and the invoking of Article 50 of the Treaty on European Union on 29 March 2017. Brexit has potential impact on Lloyd's and all other UK insurance and reinsurance undertakings to transact business within the EU.

In response to this, Lloyd's is establishing a new European insurance company to be located in Brussels, with the intention for the company to be ready to write business for the 1 January 2019 renewal season, subject to regulatory approval.

The company will be able to write risks from all 27 European Union and three European Economic Area states after the United Kingdom has left the EU, providing Lloyd's customers and partners continued access to the innovative solutions of the Lloyd's market.

A.2 Underwriting performance

The Lloyd's result for 2016 is described and analysed in detail in section 3.1 of Lloyd's Annual Report 2016 (pages 34 to 49). This provides a qualitative and quantitative description of the result at an aggregate level and by material line of business.

The overall underwriting result is summarised below:

	2016	2015
	£m	£m
Net premiums earned	22,660	20,565
Net claims incurred	(12,987)	(10,262)
Net operating expenses	(9,205)	(8,256)
Total	**468**	**2,047**
Combined ratio	97.9%	90.0%

The underwriting result by material line of business is summarised below:

	2016	2015
	£m	£m
Reinsurance	548	904
Property	(202)	501
Casualty	(146)	(5)
Marine	(129)	108
Energy	59	247
Motor	(103)	(17)
Aviation	71	19
Life	(8)	(3)
Sub-total	**90**	**1,754**
Transactions between syndicates and the Society	378	293
Total	**468**	**2,047**

A summary of business by major geographical location is set out in section A.1 above.

The Lloyd's market achieved a pre-tax profit of £2,107m in 2016 (2015: £2,122m) and a combined ratio of 97.9% (2015: 90.0%), which represents a return on capital of 8.1% (2015: 9.1%).

The underwriting result has deteriorated while investment return has improved positively. Foreign exchange gains have also contributed.

On an accident year basis, market conditions in 2016 remained challenging, with a reported deterioration in underwriting performance. All of Lloyd's classes of business have reported accident year losses for 2016, and only three classes had prior year reserves releases that were sufficient for them to report overall profits. For the first time since 2012, aggregate major claims and insured catastrophe losses were above the long-term average in 2016. The year saw two events for which the net incurred loss to the Lloyd's market was in excess of £250m. The first of these was the Fort McMurray Wildfire in Canada in May. The second was Hurricane Matthew which struck a number of Caribbean islands, the southeastern United States and Eastern Canada in late September/early October.

The underwriting result continued to benefit from prior year releases, which accounted for £1,150m (2015: £1,621m), reducing the combined ratio by 5.1% (2015: 7.9%). The level of release is lower than in recent years but is supported by the strong level of claims reserves.

Continued downward pressure on pricing was experienced across the market in 2016, and whilst this was broadly in line with planning assumptions, competition in reinsurance continues to grow as traditional and alternative capital remains attracted to this class. Aviation, Energy, Marine and Property classes also experienced intense rating pressure.

The level of expenses continues to increase and erode underwriting margins. The Lloyd's market's expenses are higher as a proportion of net earned premium than those of our competitor group, particularly in relation to acquisition costs reflecting Lloyd's more extensive distribution chain. Administrative expenses are also higher although the Lloyd's figures are flattered by the impact of measuring mostly sterling expenses against net earned premium with a high proportion of US dollar.

A.3 Investment Performance

The investment performance for Lloyd's for 2016 is summarised below:

	2016	2015
	£m	£m
Interest and similar income:		
From financial investments designated as at fair value though profit or loss	961	603
From available for sale investments	22	24
From financial instruments designated as held to maturity	1	-
Dividend income	49	58
Interest on cash at bank	16	22
Other interest and similar income	32	29
Investment expenses	(54)	(31)
Total	**1,027**	**705**

Other income from investments designated as at fair value through profit or loss:		
Realised gains (net)	11	54
Unrealised gains/(losses) (net)	267	(378)
Other relevant income	46	23
Total	**324**	**(301)**
Other income from investments designated as available for sale (net realised losses)	**(6)**	**(2)**
Total investment return	**1,345**	**402**

Investment return was 2.2% (2015: 0.7%), the improvement being driven by the strong performance from high quality fixed interest assets.

Investment returns were strong in most markets over 2016 despite the heightened level of economic uncertainty arising from key events. This was reflected in the market's investment return of £1,345m which showed notable improvement on the previous year and was also above the five-year average.

Overall, equity and growth assets have produced strong returns with commodities being one of the best performing assets in the year.

The divergence in monetary policy measures implemented in the UK and US has led to mixed returns in bond markets. Overall, returns were in excess of prevailing yield levels, boosted by capital appreciation as risk-free yields fell in most cases.

Further information on the investment performance is provided on pages 39 and 40 of Lloyd's Annual Report 2016.

No gains or losses on investments were recognised directly in equity.

Some of Lloyd's investments are held in the form of securitised assets. These include some securitised assets held in the Central Fund and the Australian Trust Funds such as Residential Mortgage Backed Securities. FAL also contains some securitised assets. Some syndicates also hold these as well as other asset backed securities.

As at 31 December 2016, exposure to securitised and structured notes totalled £3,151m. This is represented by £3,089m of collateralised securities and £62m of structured notes.

A.4 Performance of other activities

Other items contributing to the profit of £2,107m were profit on exchange of £578m and other income of £77m, less other expenses of £361m. The foreign exchange gains were driven by the strengthening of the US Dollar coupled with a surplus of US Dollar assets over liabilities.

Other income related primarily to Society income, largely market charges and charges to members. The other expenses were primarily in respect of Society operating expenses.

Leases
Payments made under operating leases are charged to the Society income statement on a straight-line basis over the period of the lease. Contractual capital expenditure is provided for over the term of the underlying lease agreement. The lease cost provision is an accounting estimate which arises due to the fact the Society has entered into a number of fully repairing leases.

Additional information on lease cost provisions for the Society is set out in note 22 of the Society accounts at page 175 of the Lloyd's Annual Report 2016.

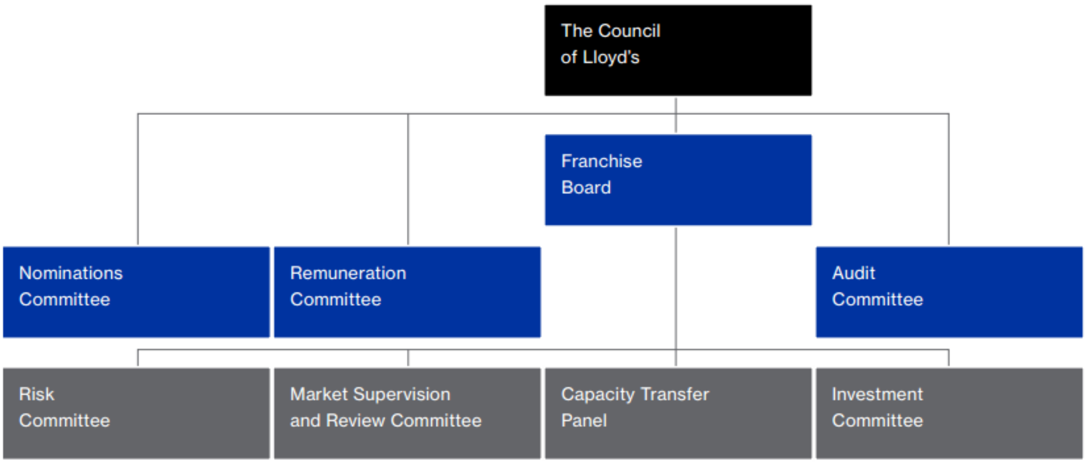
A.5 Any other information

There is no other material information to report.

B System of Governance

B.1 General information on the system of governance

Structure, roles and responsibilities
The structure of the principal governing bodies of Lloyd's is summarised in the chart below:



The Council of Lloyd's
Under Lloyd's Act 1982, the Council of Lloyd's undertakes the management and superintendence of the affairs of the Society and the power to regulate and direct the business of insurance at Lloyd's.

The Council comprises a maximum of 18 members, split between six working, six external and six nominated members. The Chairman and Deputy Chairmen are elected annually by the Council from among its members.

Certain functions are reserved to the Council including:

- The making, amendment or revocation of Lloyd's byelaws
- The setting of Central Fund contribution rates; and
- Appointing the Chairman and Deputy Chairmen of Council.

Beyond the reserved functions, the Council can delegate its powers or functions to any person, committee or employee of the Society.

The Council has delegated authority for the day-to-day management of the market to the Franchise Board. The Franchise Board is able, in turn, to sub-delegate authority to the Chief Executive Officer (CEO) and through her to the Lloyd's Executive. In addition, the Council has delegated authority to carry out specified functions to committees including the Audit, Remuneration, and Nominations Committees, as summarised below.

The Franchise Board
The Council established the Franchise Board as from 1 January 2003 and set it a goal: "To create and maintain a commercial environment at Lloyd's in which the long-term return to all capital providers is maximised".

The Franchise Board is responsible for the day-to-day oversight of Lloyd's and thus constitutes Lloyd's Administrative, Management or Supervisory Body (AMSB).

During 2016, the Franchise Board comprised a maximum of 13 members:

- The Chairman of Lloyd's;
- The Lloyd's Chief Executive Officer; the Performance Management Director; the Chief Risk Officer & General Counsel and the Chief Financial Officer (the Executive Directors);
- Three non-executives connected with the Lloyd's market; and
- Five independent non-executives.

Specific functions delegated to the Franchise Board include:

- Determining the major risks to the Lloyd's market and determining appropriate action to address or mitigate those risks;
- Determining the key factors, levers and drivers which may affect the profitability of the Lloyd's market;
- Developing and implementing a strategy to achieve the Franchise Goal; and
- Supervising, regulating and directing the business of insurance at Lloyd's.

The Franchise Board has reserved to itself a list of specific functions and powers that only it may deal with. The Franchise Board may sub-delegate authority to the CEO, executive directors and employees of the Corporation save in respect of those functions and powers reserved to it, the Council and their committees.

Matters reserved to the Franchise Board include:

- Setting the policy and principles relating to the supervision, regulation and direction of the business of insurance at Lloyd's (the Market Supervision Framework), in compliance with PRA and FCA requirements;
- Considering and approving Lloyd's risk appetite (both at Corporation and market level);
- Setting policy for the admission and removal of participants in the Lloyd's market;
- Admitting and removing managing agents;
- Determining the Franchise Standards for managing agents and approving the Three-Year and Annual Plan and Budget of the Corporation; and
- Approving the Lloyd's Society level capital requirements.

The Principal Committees of the Council

Audit Committee

The Audit Committee's role is to ensure that the financial activities of Lloyd's are subject to independent review and audit.

The Audit Committee comprises a maximum of 10 members one of whom shall be the Chairman of the Audit Committee and one of whom may be the Deputy Chairman of the Audit Committee, and shall comprise no more than:

- five members of the Council;
- three independent non-executive directors of the Franchise Board with relevant experience or qualification; and
- two connected non-executive directors of the Franchise Board.

The Audit Committee's functions include:

- Reviewing Lloyd's annual and interim financial statements, the aggregate syndicate results and the Lloyd's Solvency & Financial Condition Report; and
- Reviewing both the external and internal audit plans and the compliance plan.

Reports from the internal and external auditors on aspects of internal control and reports from the Legal and Compliance department on internal and international compliance are reviewed by the Audit Committee and appropriate action taken in response.

The Audit Committee submits an annual report to the Council. It also reports to the Council and the Franchise Board on its proceedings after each meeting. Additional reports are submitted to the Council and/or the Franchise Board on matters of material interest as and when necessary. The minutes of Audit Committee meetings are submitted to the Franchise Board and the Council.

Nominations Committee

The Nominations Committee is responsible for making recommendations to the Council on the appointment of the Chairman, CEO, new nominated Council members, Franchise Board members (including the executive directors on the Board), members of a number of the Council and Franchise Board committees to consult with the CEO on the appointment of members of the Executive who are not members of the Franchise Board including the Secretary to the Council. The Nominations Committee is also responsible for succession planning arrangements for these positions.

The Nominations Committee shall comprise not more than six members and is chaired by the Chairman of Lloyd’s. Its remaining members are drawn from both the Council and the Franchise Board.

The Nominations Committee reports to the Council and Franchise Board on its proceedings after each meeting on all matters relating to its duties and powers. A written report is submitted to the Council annually.

Remuneration Committee

The Remuneration Committee is responsible for setting remuneration arrangements for the Chairman, CEO, executive directors and the Secretary to the Council. The Remuneration Committee’s proposals are considered by both the Franchise Board and the Council.

Non-executive remuneration is decided by the Council, on recommendation from the Chairman and CEO who may consult the Remuneration Committee as part of that process.

The Remuneration Committee shall comprise not more than six members and is chaired by the Senior Independent Deputy Chairman. The Chairman is a member of the committee and its remaining members are drawn from both the Council and the Franchise Board.

The Remuneration Committee reports to the Council and Franchise Board on its proceedings after each meeting on all matters relating to its duties and powers and makes recommendations to the Council or Franchise Board on any area within its remit where action or improvement is needed. The Remuneration Committee submits a written report to the Council annually.

The Principal Committees of the Franchise Board

Risk Committee

During 2016 Risk Committee was composed of Executive Directors. It was chaired by the CEO and its other members were the Performance Management Director, the

Chief Risk Officer & General Counsel and the Chief Financial Officer. Other senior members of staff, including the Head of Risk Management, Head of Internal Audit, Lloyd's Actuary, and the Secretary to the Council, attend meetings as appropriate. It reports quarterly to the Franchise Board. It also provides regular updates to the Audit Committee and the Council.

From 1 January 2017 the composition of the Risk Committee changed to be composed entirely of non-executive members drawn from the Franchise Board and the Council.

Market Supervision and Review Committee
Market Supervision and Review Committee (MSARC) takes decisions regarding the exercise of Lloyd's enforcement powers. It also acts as a review body capable, where appropriate, of amending, modifying or withdrawing certain decisions taken by the Executive affecting managing agents. It also acts as the body that determines whether certain decisions can be referred to the Lloyd's Appeal Tribunal and can also make certain business decisions.

MSARC meets at the discretion of its Chairman. MSARC submits a written report to the Franchise Board annually and may submit additional reports to inform the Franchise Board of any matters of material concern as and when required.

Capacity Transfer Panel
The Capacity Transfer Panel (CTP) was established principally to exercise the Council's powers in relation to minority buyouts and mergers. The Panel meets at the discretion of its Chairman. The Panel submits a written report to the Franchise Board annually and may submit additional reports on matters of material concern as and when necessary.

Investment Committee
The Investment Committee monitors the investment objectives and parameters of centrally managed assets and is responsible for reviewing the performance of these funds. In addition, it monitors the investment operations of Lloyd's Treasury and Investment Management department in respect of all funds under its management and approves all investment counterparties. It may also make more general recommendations concerning investment activity at Lloyd's.

The Investment Committee meets at the discretion of its Chairman. The Investment Committee submits a written report to the Franchise Board annually and may submit additional reports on matters of material concern as and when necessary. The Investment Committee is required to obtain the approval of the Franchise Board before making any decisions which may materially affect the financial risks applying to the Society or Lloyd's market entities.

Executive Committee
The purpose of the Executive Committee is to act as a communication forum for the key issues and actions relating to the management of the franchise and the affairs of the Corporation, ensuring that key issues are identified and discussed with decisions taken at the appropriate level.

The Executive Committee comprises the Chief Executive Officer, the Directors, and such other persons as the Chief Executive may from time to time appoint. Currently the membership includes the interim Head of Marketing and Communications, the Chief Financial Officer, the Chief Commercial Officer, the Chief Operating Officer, Chief Risk Officer, the Human Resources Director, the General Counsel and

Secretary to the Council and the Franchise Board, the Performance Management Director and the Chief Strategy Officer.

Material changes in the system of governance that have taken place over the reporting period

Risk Committee
With effect from 1 January 2017 the composition of the Lloyd's Risk Committee has changed to be comprised entirely of independent non-executive members. This is to reflect refinements in corporate governance consistent with Solvency II and to increase the independence of the governance in respect of risk. Other individuals including the CEO, Chief Risk Officer, Chief Financial Officer and Performance Manager Director are regular attendees with others invited to attend all or part of any meeting as and when deemed appropriate by the Risk Committee or its Chair.

Further information on Lloyd's system of governance may be found in section 4.2 (page 81 to 96) of Lloyd's Annual Report 2016.

Information on the remuneration policy

Principles of the remuneration policy
Lloyd's operates a Total Reward approach to remuneration, which is designed to meet employee and Corporation needs by providing rewards that are linked to individual performance and the delivery of Lloyd's Corporation objectives.

Lloyd's Total Reward approach is supported by the following practices:

- The approach looks beyond base salary to the value of the total reward package in meeting the needs of employees;
- Lloyd's recognises and rewards superior performance; and
- Lloyd's remuneration practices are designed to promote and reward sound and effective risk management.

The Corporation operates a balanced approach to performance measurement. The annual bonus is linked to Lloyd's key strategic objectives outlined in Vision 2025. KPIs are set each year which support the delivery of Lloyd's long-term vision. The Lloyd's Performance Plan (LPP) is directly linked to the profitability of the Lloyd's market to encourage an attitude of commercial partnership with the market and align the interests of participants with capital providers.

The Corporation's executive remuneration policy

The structure of total compensation for the CEO and executive directors is designed to support the strategic priorities of Lloyd's Vision 2025 and reflect the market oversight role of the Corporation. The fixed element is higher and the variable (performance-related) element lower, in order to better reflect the nature of the organisation.

Lloyd's reward policy is designed to facilitate the future success of the Corporation by ensuring that the executive package may be sufficient to attract executive directors of the calibre required to deliver the Corporation's strategic priorities. It seeks to ensure that no more than is necessary is paid on recruitment, while taking into account a highly competitive and global market for talent.

All of Lloyd's executive remuneration practices are designed to protect the brand and reputation of Lloyd's and to promote sound and effective risk management.

Incentives (annual bonus and LPP) are subject to a potential downward adjustment if risk management practices and standards are not considered to have been sufficiently met.

To ensure the long-term sustainability of the Lloyd's brand and reputation, the Corporation operates malus and clawback provisions on all incentives to ensure that senior executives act responsibly and in the long-term interests of the Corporation.

Summary of executive remuneration policy for 2017

Salary - Salaries are set to appropriately recognise responsibilities and be broadly market competitive. For 2017, salaries are set as follows: CEO: £715,000; Chief Financial Officer: £425,000; and Performance Management Director: £500,000.

Annual bonus - The discretionary annual bonus plan links reward to specific and measurable targets aligned with Lloyd's Vision 2025 strategy. For 2017, annual bonus maximums (as a % of salary) are: CEO: 75% (45% on target); Chief Financial Officer: 50% (30% on target); and Performance Management Director: 50% (30% on target). From 2016, annual bonus awards are subject to a 'risk underpin'. The Remuneration Committee will assess performance against risk and compliance metrics, and may apply a downward adjustment where appropriate. For awards in respect of 2016 onwards, a portion of the annual bonus may be deferred for three years, so that total incentives meet the PRA guidance to defer at least 40% of total variable pay.

LPP - this offers an incentive which is directly linked to the profitability of the Lloyd's market. For 2016 and subsequent years, for the CEO and executive directors, it is intended that the whole of the LPP award will be deferred for three years and will be paid in the fourth financial year following the end of the performance period. For the CEO and executive directors, a maximum cap of 50% of salary applies. From 2016, LPP awards are subject to a 'risk underpin'. The Remuneration Committee will assess performance against risk and compliance metrics, and may apply a downward adjustment where appropriate.

Pension - The CEO and Performance Management Director are members of the Group Pension Plan (or equivalent), which is a defined contribution plan. The Chief Financial Officer participates in the Lloyd's pension scheme, which is a defined benefit scheme no longer open to new joiners. All executive directors receive a cash allowance of 20% of base salary.

Variable components of remuneration

Lloyd's variable components of remuneration consist of the following elements:

- Annual bonus
- LPP

From 2016, the annual bonus and LPP awards are subject to a 'risk underpin'. The Remuneration Committee will assess performance against risk and compliance metrics, and may apply a downwards adjustment where appropriate.

Annual bonus

The Annual bonus is a discretionary annual bonus plan which links reward to specific and measurable targets aligned with Lloyd's Vision 2025 strategy. All Corporation employees are eligible for a discretionary annual bonus, based on performance against objectives and individual key performance indicators for the year.

Individual payouts are based on the Remuneration Committee's judgement of performance against corporate and individual key performance indicators (KPIs) for the year. The Remuneration Committee reviews strategic and operational objectives and KPIs at the start of the financial year. These help in determining the annual bonus awards for the year and ensure that annual bonus awards are aligned to the Corporation's strategic objectives.

LPP

The LPP is available to all employees and has been designed to meet strategic objectives by enabling the Corporation to offer an incentive which is directly linked to the profitability of the Lloyd's market and will therefore encourage an attitude of commercial partnership with the market and align the interests of participants with capital providers; and will provide a competitive reward and therefore assist Lloyd's in attracting and retaining the talented individuals required to develop and support future strategy.

Awards under the LPP (LPP Awards) are calculated by reference to profit on ordinary activities before tax (PBT), as reported in the pro forma financial statements in the Lloyd's Annual Report for each financial year. LPP Awards will only be triggered if PBT in excess of £100m is achieved.

The LPP Awards for each financial year will be calculated as a percentage of the participants' salaries at 31 December in that year, for each £1bn of PBT.

The framework for determining LPP Awards is as follows:

Job level	Amount of LPP award	Limit on LPP award
CEO and directors appointed after 1 January 2014	15% of salary per £1bn of PBT	50% of salary ie £3.3bn of PBT
Other directors	20% of salary per £1bn of PBT	100% of salary ie £5bn of PBT
Senior managers	10% of salary per £1bn of PBT	30% of salary ie £3bn of PBT
Other employees	5%-3% of salary per £1bn of PBT depending on grade	15%-9% of salary (depending on grade) ie £3bn of PBT

For 2016 and subsequent years, in respect of the CEO and all directors and senior managers, any LPP award will be deferred until April in the fourth year following the end of the relevant financial year, subject to the PRA's proportionality test based on total compensation and the proportion of variable compensation paid in respect of the relevant financial year. Therefore, for 2016 awards, any LPP payment will be deferred and paid in April 2020. For employees whose remuneration is below the PRA's proportionality test (e.g. some senior managers), the LPP will revert to the ongoing fund basis. Under this approach, one half of an award will be paid in April following the relevant financial year, with the remaining 50% paid one year later. This is not intended to apply to the CEO and executive directors, who are expected to fall above the proportionality test and be subject to the full deferral period.

Remuneration for the Chairman and members of the Council of Lloyd's and Franchise Board who are not employees of the Corporation

The Chairman's remuneration was not increased in 2016 and remains unchanged at £575k per annum for 2017. Fees for 2016 for Council and Franchise Board members were £38,500 and £62,000 per annum respectively. Fees are unchanged for Franchise Board members for 2017. Fees are also payable in respect of membership of a number of Council and Franchise Board committees, including ad hoc committees established to consider specific issues requiring a significant time commitment. These have remained at 2016 levels. For 2016 the additional fee payable to the Deputy Chairmen, over and above the standard Council member's fee, was £11,000 per annum. It is unchanged for 2017

Supplementary pension or early retirement schemes for the members of the administrative, management or supervisory body and other key function holders
Lloyd's provides a 20% cash allowance for the CEO and all Executive Directors. For those Executive Directors in the Lloyd's Pension Scheme (a defined benefit scheme no longer open to new joiners), this allowance is to compensate for benefits being based on the scheme earnings cap rather than base salary. For other Directors and the CEO, it supplements Lloyd's contribution into the Group Personal Pension arrangement.

Further information on Lloyd's remuneration policy is set out in section 4.4 (pages 99 to 116) of Lloyd's Annual Report 2016.

Material transactions during the reporting period with persons who exercise a significant influence on the undertaking, and with members of the administrative, management or supervisory body
There were no relevant material transactions during the reporting period.

B.2 Fit and proper requirements

Requirements for skills, knowledge and expertise
Lloyd's Fit and Proper Policy sets out how Lloyd's establishes, implements and maintains documented policies and procedures to ensure that the persons who effectively run the Corporation or are responsible for other key functions, behave with integrity, honesty and skill.

The purpose of the policy is to ensure that the relevant persons at all times:

- have the personal characteristics (including being of good repute and integrity);
- possess the level of competence, knowledge and experience;
- have the qualifications;
- have undergone or are undergoing all training required to enable them to perform their functions effectively and in accordance with any relevant regulatory requirements and to enable the sound and prudent management of Lloyd's; and
- discharge their functions in accordance with the relevant FCA and PRA Conduct standards.

The Policy applies to:

- Members of the Council and Franchise Board who hold specific Senior Insurance Manager Functions (SIMF) and are required to be pre-approved (including Chairman, Chair of Remuneration Committee, Chair of Audit Committee, CEO, Chief Financial Officer, Chief Risk Officer and General Counsel, and Director, Performance Management);
- All other members of the Council and Franchise Board who have to be notified to the PRA and FCA as notified non-executive directors;

- Corporation employees who hold SIMF or controlled functions and are required to be approved by the PRA and FCA or notified to the PRA and FCA (other members of the Executive Committee, and Head of Lloyd's Treasury & Investment ('Key Function Holders'));
- Corporation employees who are "Key Function Performers" (primarily the Senior Leadership Team – typically departmental heads who report directly to members of the Executive Committee).

In relation to the Council and Franchise Board, the Nominations Committee is responsible for recommending appointments to the Board and for nominated members of the Council.

Given that 12 of the 18 members of Council are required by Lloyd's Act 1982 to be elected by members of the Society it is not possible or appropriate for the Nominations Committee to have specific obligations in respect of the balance of expertise and experience represented on Council. However, for the Board, the Committee does regularly review the structure, size and composition (including skills, knowledge & experience) of the Board and make recommendations to the Council about any changes. Before making any recommendation regarding candidates for appointment to the Franchise Board and for nominated members to the Council the Nominations Committee uses its best endeavours to evaluate the balance of skills, knowledge, experience and diversity on the Council or Franchise Board as appropriate and, in light of this evaluation prepare a description of the role and capabilities required for a particular appointment.

In relation to Corporation employees, candidates are recruited though Lloyd's recruitment process which comprises competency based interviews to enable Lloyd's to assess whether a candidate has the appropriate skills, knowledge and experience for the particular role in question.

<u>Process for assessing fitness and propriety</u>
The process for assessing the fitness and propriety of the persons who effectively run the Corporation or have other key functions is described in the Fit and Proper Policy which sets out how Lloyd's performing the necessary fitness and propriety checks prior to appointment and periodically thereafter the various categories of roles to which the policy applies.

In summary, the Chairman annually reviews the performance of the non-executive members of the Council and the Board and the Senior Independent Director reviews the performance of the Chairman. The Remuneration Committee reviews the performance of the Chairman, CEO and the Executive Committee. The Chief Financial Officer is responsible for reviewing the performance of the Lloyd's Chief Actuary through Lloyd's Performance Appraisal Process. The Audit Committee is responsible for annually reviewing the performance of the Head of Internal Audit and the results of this review are shared by the Chair of the Audit Committee with the CEO who jointly agree remuneration. Other employees who are either key function holders or performers are assessed through Lloyd's performance appraisal process. These reviews take into account the FCA/PRA requirements for fitness and propriety and conduct.

B.3 Risk management system including the own risk and solvency assessment

Risk management system

The Lloyd's Risk Management Policy describes its overall framework and approach for the management of risk, including the risk strategy, the internal governance arrangements, tools, processes and reporting procedures.

The Lloyd's Risk Management Framework ('the framework') ensures that the identification, assessment, monitoring and management of all material risks affecting the Society takes place on an ongoing basis. The framework includes a number of risk assessment techniques, which are tailored to specific risk areas.

Lloyd's Risk Management Framework

Lloyd's adopts a consistent approach in managing its risks through a process known as the risk and control assessment process, which is conducted on a quarterly basis. This process re-assesses the existing risks and identifies any new risks. It evaluates the performance of key controls and also seeks to monitor the action plans in place to help manage risks.

The framework also enables Lloyd's to undertake a more forward looking assessment of risk, building capital consideration into decision making processes. An Own Risk and Solvency Assessment (ORSA) is performed at least annually, bringing together key risk, capital and solvency management information on a more formal basis for the Franchise Board on a current and future basis.

Implementation of risk management system

The management of all risks is, first and foremost, the responsibility of each employee and department at Lloyd's and decisions taken across the business have the potential to impact the risk profile of Lloyd's to a greater or lesser degree.

The Risk Management Function is responsible for providing a secondary check and balance to ensure the range of risks taken by Lloyd's are well understood, effectively managed and in line with Lloyd's overall strategy and risk appetite. This objective is achieved through operation of the risk management framework.

The Risk Management Function is composed of the risk governance structure and the Risk Management Department. The risk governance structure comprises the Risk Committee plus three specialist sub-committees: the Syndicate Risk Committee, the Financial Risk Committee and the Corporation Risk Committee. These provide clear independent challenge to the risk takers at Lloyd's and enables tailored risk management operating models, rather than a 'one-size-fits-all' platform. The risk committees oversee, challenge and where appropriate escalate issues using appropriate management information sourced from the Risk Management and internal control frameworks, such as the various risk and control assessments, details of the operating and regulatory environment and capital management reports.

A key objective of the Lloyd's risk governance structure is to provide assurance to the Franchise Board that risks facing the Society are identified and managed in accordance with approved policy and risk appetite. The Risk Appetite Framework articulates the level of risk believed to be acceptable and desirable for Lloyd's through a series of risk appetite statements and metrics. These are monitored on an ongoing basis by both the business areas responsible for each risk area and the relevant risk committee.

ORSA process

The ORSA process is a key element of the risk management framework of Lloyd's. It incorporates a series of processes which ensure an appropriate level and quality of capital is maintained to support the risks taken within Lloyd's on a current and future basis in light of the Lloyd's strategy set by the Franchise Board. The key focus of the ORSA is to continually assess Lloyd's own view of the risks faced and associated economic capital needs in order to meet its strategic goals.

The ORSA draws on existing ongoing oversight activities used to manage market and Corporation risk (including the risk and control assessment process, business plan and capital approval), the member capital setting processes and the determination of a central capital layer.

ORSA frequency, review and approval

'Business as usual' basis

The ORSA is an ongoing, continuous process which aligns to the Lloyd's business cycle. As such, the activities of the ORSA are performed through the course of the year and at least annually in line with changes to the Lloyd's risk profile and capital setting cycle. The risk profile is assessed on a quarterly and annual basis. The ORSA report is presented to the Franchise Board on a quarterly (in summary version) and annual (detailed version) basis.

Ad-hoc basis

Following the occurrence of a significant event, the activities within the ORSA may be revisited to ensure that they are still valid and to assess any potential impact on the level of economic capital and the own funds necessary to meet solvency requirements. Certain trigger events may require all activities within the ORSA process to be revisited, however less material events may only trigger the review of some ORSA components.

Governance

The Franchise Board has overall responsibility for the review and approval of the ORSA process and report.

The Franchise Board will make key decisions and review and approve key outputs through the ORSA report but shall sub-delegate the day-to-day oversight and operation of the ORSA process to the relevant committee and function teams as detailed in the Lloyd's ORSA Policy.

Determination of own solvency needs and interaction of capital management activities with the risk management system

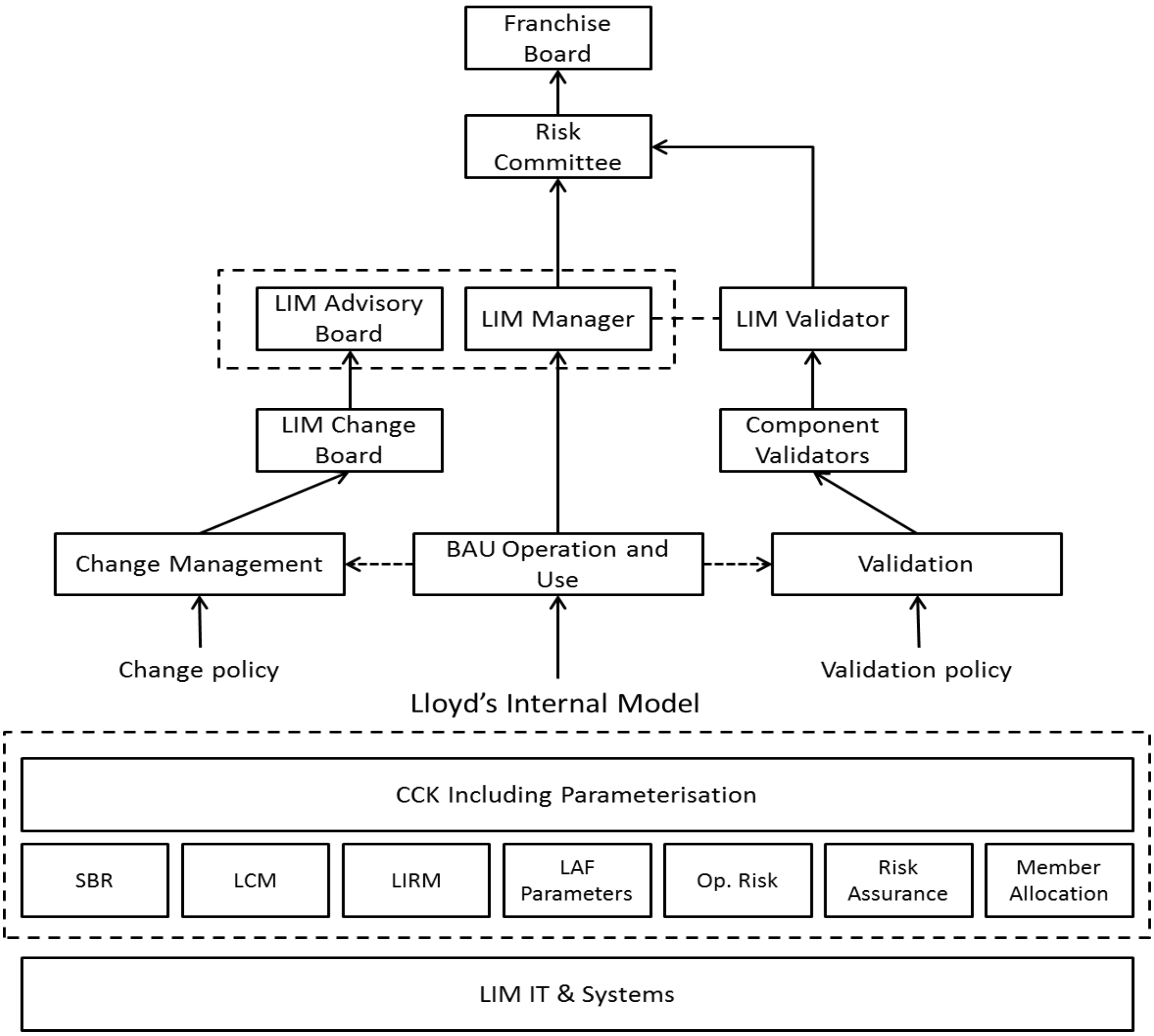
The outcome of the ORSA process is formally documented within the ORSA report. The ORSA report details how Lloyd's has completed its own solvency assessment given its risk profile. Furthermore, it is used to present the results of the various, inter-linked ORSA processes, illustrating the dependencies between strategy, risk, capital and solvency. It provides all the key information which has been assessed and the conclusions reached as part of the ORSA process in order to provide management with a suitable platform for appropriate oversight and for future strategy setting.

Governance over the Lloyd's Internal Model (LIM)

The LIM is owned by the Franchise Board, which relies on the LIM outputs for key decision making activities. Franchise Board delegates day-to-day duties to the Risk Committee to ensure that the design, operation and validation of the LIM are appropriate.

Lloyd's has embedded the structure set out below to ensure effective governance and oversight of the operation, validation and change of the LIM and to ensure that the internal model continues to appropriately reflect the risk profile of the Society.

The Governance framework highlighted below identifies those ultimately responsible for ensuring effective governance of the LIM and satisfying themselves that the operation, change and validation activities are performed in alignment with their respective policies as well as the components involved in the business as usual (BAU) operation and use activities of the LIM, change management processes and the regular cycle of internal model validation.



<u>Internal model validation</u>
Validation is a key regulatory requirement and seeks to ensure that the LIM is both fit for purpose and that its outputs can be relied upon to make key strategic decisions across the Society. A successful validation is one of the key requirements for maintaining internal model approval.

All LIM processes will be validated across the eight validation areas: data, methods, assumptions, expert judgement, documentation, governance, systems & IT and use. In addition, the appropriateness of the overall model will be validated.
Validation tools are methods and approaches that may be applied to a LIM processes to ensure that it is appropriate. In order to validate the LIM processes across the validation areas, the validator will choose a selection of both quantitative and qualitative tools. The table below outlines the possible suite of validation tools available:

Validation areas	Validation Tools								
	Tests of model functioning	Analysis of change	Test results vs experience	Stability testing	Sensitivity tests	Stress & Scenario tests	P&L Attribution	Benchmark	Qualitative review
Data		✓	✓		✓				✓
Methods		✓	✓	✓	✓	✓	✓	✓	✓
Assumptions		✓	✓	✓	✓	✓	✓	✓	✓
Expert judgment		✓	✓	✓	✓	✓	✓	✓	✓
Documentation									✓
Governance									✓
Systems & IT									✓
Use test									✓
Overall model	✓								

The LIM validation cycle is completed at least annually. This does not necessarily mean that the LIM components will only be validated yearly. Instead, the LIM Validator and each Component Validator will need to specify frequency of components and sub-components validation, as well as ad hoc validation driven by occurrence of trigger events.

Lloyd's approach to the LIM validation ensures independence throughout the validation process. This is designed to ensure that the Validation is separated from ownership of and interest in the LIM or its constituent components. This is demonstrated through clear allocation of roles and responsibilities to LIM Validator, Component Validator and Component Owner.

The LIM Validator is responsible for defining the scope and coverage of the validation. The Component Validator is responsible for specifying the validation tests to be performed and for conducting these tests. In some instances the Component Owner will conduct validation activities which are subsequently reviewed by the Component validator or LIM validator, where this is considered appropriate. Subsequently, the Component Validator is responsible for interpreting the test results and scoring them. This requires the Component Validator to have the appropriate level of expertise to interpret the results and provide robust challenge.

The above process is supported by clear and transparent recording of results and the escalation of issues to the LIM Validator, Risk Committee and Franchise Board, if required.

In addition, if no suitable internal resource can be found to validate certain aspects of the model component(s) / LIM, external resources can be brought in to support the process. For the current validation, the Head of Internal Audit is supported by Willis Towers Watson and Deloitte as the insourced Internal Audit team.

B.4 Internal control system

Internal control system

An effective system of internal control is a critical component of a successful business: it provides the foundation for the safe and sound operation of a business, ensuring compliance with relevant laws and regulations and the safeguarding of assets.

Internal control at Lloyd's comprises a set of continually operating processes involving the Franchise Board, as Lloyd's AMSB, senior management and all levels of personnel who by acting together ensure that the specific goals and objectives of Lloyd's are met and that a strong control culture is prevalent across the business.

An effective internal control system is key to embedding responsibility for risk management across the business and supporting the attainment of overall business strategy. The internal control system is designed to reduce, rather than eliminate, the risk of failure to achieve business objectives and can only provide reasonable but not absolute assurance against material misstatement or loss.

The Franchise Board, on behalf of the Council of Lloyd's, has responsibility for the Society's system of internal control and for reviewing its effectiveness. The Audit Committee monitors and reviews the effectiveness of the system of internal control, providing biannual reports to the Franchise Board. The Executive Committee is responsible for the implementation and maintenance of the internal control system and for instilling a strong internal control environment across the Corporation and market.

Lloyd's internal control system provides the foundation for the safe and sound operation of the business, ensuring compliance with relevant laws and regulations and the safeguarding of assets. The system is designed to reduce, rather than eliminate, the risk of failure to achieve business objectives and can only provide reasonable but not absolute assurance against material misstatement or loss.

The Internal Control Policy describes the way in which the key components of the Lloyd's internal control system act together to ensure assurance processes are operationalised and risk oversight is effected. This policy describes key processes such that Lloyd's can consistently demonstrate:

- Effectiveness and efficiency of operations;
- Compliance with applicable laws, regulations and administrative provisions; and
- Availability and reliability of financial and non-financial information.

Implementation of the compliance function

The compliance function, part of the Legal & Compliance department, focuses on:

- Maintaining Lloyd's relationship with the PRA and FCA
- Reviewing regulatory requirements for impact on the Corporation and liaising with management on changes to processes; and
- Periodically checking that management processes meet PRA / FCA rules (by audits conducted by Internal Audit).

The Compliance function reports updates on PRA / FCA issues to the Corporation Risk Committee, the Risk Committee and Audit Committee.

B.5 Internal audit function

Implementation of the internal audit function
The Internal Audit function provides independent and objective assurance over the design and effectiveness of controls in place to manage the key risks impacting Lloyd's business performance.

Internal Audit is accountable for developing and delivering a programme of assurance aimed at validating the effective management of key business risks. Internal Audit report its findings, conclusions, and recommendations to the audited parties, Executive Committee and Audit Committee, and ensures timely follow-up on management actions.

To ensure adequate audit coverage of the Company's systems and controls an "audit universe" is prepared by Internal Audit. The annual Internal Audit Plan is derived from the audit universe, providing consideration of rotation of audit areas and areas of greatest risk. The planning approach includes interviews with each executive and key senior managers in the Corporation. The Plan is submitted to the Executive Committee for their review prior to approval by the Audit Committee.

Independence of the internal audit function
The Internal Audit Charter and Operating Standards establish the framework in which the internal audit function operates. This includes affirming the independence of the internal audit function, stating that internal audit must be independent from management at all times in order to be effective in executing its work freely and objectively, including:

- Internal Auditors have no direct responsibility or authority over any operating activities reviewed and should not relieve others of their responsibilities;
- Internal Audit are specifically prohibited from performing management activities, including:
  - performing operational duties, including operation of policies and procedures;
  - initiating or approving accounting transactions; and
  - undertaking consulting engagements, specifically, those engagements where the primary aim includes process improvement, implementation of systems, or advising on operating practices (e.g. benchmarking);
- The Head of Internal Audit has a direct reporting line to, with direct and unlimited access to, the Chair of the Audit Committee and a secondary reporting line to the Chief Executive Officer;
- The Audit Committee approves Internal Audit's annual Plan and the overall budget;
- Internal Audit is authorised to review all areas of Lloyd's and has full, free, and unrestricted access to all activities, records, property, and personnel necessary to complete their work including correspondence with regulators and Franchise Board and Committees meeting minutes;
- Internal Audit is authorised to allocate resources, set frequencies, select areas, determine audit scopes and apply audit tools and techniques, and to obtain the necessary assistance and specialised services within or outside Lloyd's to accomplish its objectives;
- Internal Audit reports with significant findings will be reported in full to the Audit Committee; and

- Internal Audit has the right to be informed by management, on a timely basis, of any significant control failures identified by management or the external auditors.

Furthermore, Deloitte LLP provides co-sourced internal audit resource who report directly to the Head of Internal Audit. The Audit Committee keeps under review the relationship with Deloitte LLP and the procedures to ensure appropriate independence of the internal audit function is maintained.

B.6 Actuarial function

The Actuarial Function is a mandatory key function introduced by the Solvency II legislation. The Lloyd's Actuarial Function (LAF) carries out a number of activities during each year, both qualitative and quantitative. Lloyd's unique structure means that any requirements in respect of the Actuarial Function apply at both syndicate level and at the overall Society level. Syndicates are therefore required to have their own Actuarial Functions (SAFs) and part of the role of the LAF is to ensure these individual SAFs maintain the required standards.

The accountabilities and governance of the LAF are outlined in its Terms of Reference. The LAF and SAFs have a defined set of tasks which must be performed to adhere to the regulations as set out in the Solvency II Directive. These are to:

- Coordinate the calculation of technical provisions including:
  - Ensuring the use of appropriate methods and assumptions;
  - Ensuring sufficiency and quality of data; and
  - Comparing best estimates against experience;
- Express an opinion on the overall underwriting policy;
- Express an opinion the adequacy of reinsurance arrangements; and
- Contribute to the effective implementation of the risk management system with particular regard to risk modelling and ORSA.

The LAF meets the requirements by:

- Providing an appropriate framework (e.g. issuing guidance, standards and requirements) for syndicates to operate and monitoring compliance against this framework; and
- Complying centrally through its own activities used to monitor the market.

The work of the LAF is continuous over the course of the year. The requirements relating to technical provisions encompass the calculation exercise of these undertaken by the LAF and oversight of SAF calculations. Measures of SAF oversight include review of the SAF reports together with other quantitative and qualitative information submitted to Lloyd's. Together these exercises are designed to highlight any potential issues with the level of technical provisions for the market and take appropriate action to remedy these.

The requirement to provide opinions on reinsurance and underwriting is satisfied at individual syndicate and Society level. At the Society level this involves collaborations with other areas of the Corporation with primary oversight responsibility for underwriting and reinsurance.

Contribution to the risk management process and the ORSA is achieved through the LAF work with respect to the Lloyd's Internal Model. Evidence of similar contribution is also required from SAFs.

The LAF provides a written report to the Franchise Board, on an annual basis, documenting all the tasks that it has undertaken, results, identifying any deficiencies and giving recommendations as to how such deficiencies should be remedied. The LAF also receives reports from all SAFs on an annual basis, covering the areas outlined above.

B.7 Outsourcing

Description of outsourcing policy
Lloyd’s has established an Outsourcing Policy to ensure that the outsourcing of its functions or activities does not adversely affect Lloyd’s or the Market’s risk profile, or Lloyd’s ability to meet regulatory responsibilities. The Outsourcing Policy has been prepared in accordance with Solvency II requirements, in particular Articles 41 and 49 of the Solvency II Directive and Article 274 of the Solvency II Final Delegated Acts published in January 2015. The Policy also seeks to adhere to guidance within the FCA Handbook on Outsourcing (SYSC 13.9).

Lloyd’s performs many activities necessary for the operation of its business, including providing services required in support of the efficient running of the Lloyd’s Market. In some instances the activities may not relate directly to the operation of Lloyd’s (e.g. the ongoing provision of catering or cleaning services); alternatively it may be considered more cost effective to utilise the services of an external supplier with the necessary expertise. In these situations, Lloyd’s may enter into an outsourcing arrangement with a third party supplier.

Outsourcing arrangements result in a shift from direct to indirect operational control of the activity and have the potential to increase the exposure of Lloyd’s to operational risk. The Franchise Board, as Lloyd’s AMSB, remains fully responsible for any activity or function outsourced and ensures that Lloyd’s does not outsource any activity which will unduly raise its exposure to operational risk.

Lloyd’s seeks to ensure adequate control is retained over outsourced activities or functions by actively managing and monitoring relationships with third party suppliers to ensure that outsourced services perform satisfactorily.

Outsourcing of critical or important operational functions or activities
Lloyd’s is currently utilising several suppliers to undertake critical or important activities on its behalf. Details of the activities they provide and the jurisdictions they operate in are shown in the table below:

Services Provided	Jurisdiction
Market critical regular and bespoke data and reporting	United Kingdom
Managed Services – IT Application & Facilities Management	United Kingdom
Lloyd’s Settlements & Trust Fund operations	United Kingdom
Software provider of systems to exchange business information with syndicates for Lloyd’s China	China
Support & Development of Lloyd’s website	United Kingdom
Professional Services – Legal & Tax Services	United Kingdom

Services Provided	Jurisdiction
Insurance Transaction Services for Lloyd's Canadian business	Canada
Internal Audit	United Kingdom
Actuarial Services – Annual Statement of Actuarial Opinion for Lloyd's Hong Kong business	Hong Kong
Lloyd's Internal Model Validation	United Kingdom
Lloyd's Investment Risk Model	United Kingdom
Provider of Risk & Direct Report solutions to the Market	United Kingdom
Provider of regulatory reporting systems for US & Canada	United Kingdom
Provider of Settlements software, supported by onsite technician	United Kingdom
Provider of Fund management systems, supported by dedicated Lloyd's team	United Kingdom
Provider of complaints system as well as all system maintenance and support	United Kingdom
Providers of company ownership to dormant corporate members	United Kingdom
Workplace recovery facility	United Kingdom
Provider of Auction software & support	United Kingdom
Provider of coverholder business system for Lloyd's Japan	Japan

B.8 Any other information

Assessment of adequacy of the system of governance
In accordance with the UK Corporate Governance Code, an external and independent evaluation of the performance of the Council, Franchise Board, Audit, Remuneration and Nominations Committees is undertaken every three years. The next external evaluation is due to be undertaken in 2018.

The Secretary to the Council conducted an assessment of the Council, Franchise Board, Audit, Remuneration and Nominations Committees towards the end of 2016. The assessment was based on the results of questionnaires issued to the members of these bodies.

The principal conclusion of the assessment was that the current governance arrangements were working effectively and in accordance with the Governance Policies and that the Council and its principal committees were operating in accordance with their terms of reference.

The recommendations for improvement will be taken forward under the guidance of the Chairman and the Secretary to the Council.

Any other material information

Next Chairman of Lloyd’s

On 20 February 2017, the Council confirmed the appointment of Bruce Carnegie-Brown to become the next Chairman of Lloyd’s from June 2017.

There is no other material information to report.

C Risk profile

Overview

At Lloyd’s, the risk profile originates from both syndicates and at central level.

Syndicates are the source of the majority of risks. They source all of the insurance business; manage the bulk of the asset portfolios; hold the majority of the counterparty exposures; and conduct most of the day-to-day operational activity. The syndicate risks include: Insurance risk (underwriting, reserving and catastrophe risk); market risk on central assets; market risk on syndicate assets (including credit risk on Premiums Trust Funds (PTF)); reinsurance and other credit risk; and syndicate operational risk.

At the central level, additional risks arise from central operational risk and pension fund risk.

Solvency Capital Requirement (Solvency II basis)

The Solvency Capital Requirement (SCR) represents the amount of capital required to withstand a 1 in 200 year loss event over a 12 month time horizon. Given Lloyd’s unique structure there are two SCRs which are monitored under the Solvency II regime:

- The Lloyd’s market wide SCR (MWSCR) is calculated to cover all of the risks of ‘the association of underwriters known as Lloyd’s’, i.e. those arising on syndicate activity, members’ capital provided at Lloyd’s and the Society taken together, at a 99.5% confidence level over a one year time horizon as provided for in Solvency II legislation. All of the capital of the component parts of the market taken together are available to meet the MWSCR.

- The Lloyd’s central SCR (CSCR) is calculated in respect of only the risks facing the Society and the Central Fund at the same confidence level and time horizon used to calculate the MWSCR. The material risk is that members do not have sufficient funds to meet their underwriting losses even having complied with Lloyd’s rigorous capital setting rules.

Individual syndicates are also required to calculate a SCR, at a 99.5% confidence level over a one year horizon, for each underwriting year; this drives the determination of member level SCRs. Each member’s SCR is derived as the sum of the member’s share of the syndicate’s one year SCR. Where a member participates on more than one syndicate, a credit for diversification is provided to reflect the spread of risk. The MWSCR and CSCR are derived from the Lloyd’s Internal Model which has been approved by the PRA. Individual syndicates also derive SCRs from their own internal models which are subject to approval by the Lloyd’s Capital and Planning Group. The appropriateness of each syndicate’s internal model, including changes thereto and the reasonableness of the key assumptions are assessed as part of the Corporation’s oversight of the Lloyd’s market.

Lloyd’s Internal Model

The Lloyd’s Internal Model (LIM) is a purpose built model designed to calculate the MWSCR and CSCR as required under Solvency II. It covers all risk types and all material risks for the aggregation of syndicates as well as for the Corporation, allowing for the unique capital structure of Lloyd’s. The LIM consists of three main components: the Lloyd’s Investment Risk Model (LIRM) which simulates economic variables and total assets returns; the Lloyd’s Catastrophe Model (LCM) which models catastrophe risk using syndicates' views of risk; and the Capital Calculation Kernel (CCK) which is the main element of the LIM where all other risks are simulated and all risks are combined.

Syndicates calculate their own SCR however the market wide and central capital requirements are derived from Lloyd's parameterisation at a whole market level to build a view of total market capital requirements from the ground up using market level assumptions. The LIM uses a methodology whereby losses from insurance and other risks are simulated by class of business, allocated to syndicates and through to members to assess the level of capital required by the market and centrally to meet 1 in 200 year losses over the one year time horizon.

Lloyd's MWSCR
The MWSCR is broken down into the various risk components at 31 December 2016 as shown below.

	£m
Reserving risk	3,421
All other (attritional) underwriting risk	6,008
Catastrophe risk	5,129
Market risk	293
Reinsurance credit risk	885
Operational risk	645
Pension risk	23
MWSCR before adjustments	**16,404**
Foreign exchange adjustment to reflect the strengthening of the US dollar against sterling in the second half of 2016	796
MWSCR	**17,200**

C.1 Insurance Risk (including underwriting risk)

The dominant category of risk faced by Lloyd's syndicates is insurance risk. This is the risk arising from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities. In practice, insurance risk can be subdivided into:
(i) underwriting risk;
(ii) reserving risk; and
(iii) catastrophe risk.

Underwriting risk
This includes the risk that a policy will be written for too low a premium, provide inappropriate cover, or that the frequency or severity of insured events will be higher than expected.

Underwriting strategy is agreed by the board of each managing agent and set out in the syndicate business plan that is submitted to the Corporation for approval each year. Approval of business plans – and setting the capital requirements needed to support these plans – is the key control the Corporation uses to manage underwriting risk.

The Corporation reviews each syndicate business plan to ensure it meets Lloyd's standards and is consistent with the capabilities of the managing agent. Once a plan is agreed, the Corporation uses performance management data to identify whether each syndicate's business performance is progressing in line with the business plan or that variations are understood and accepted.

The managing agents' underwriting controls should ensure that underwriting is aligned with their strategy, agreed business plan and underwriting policy. Managing agents are expected to have controls in place to ensure that regulatory requirements and the scope of Lloyd's market licences are clearly understood and that risks are written within those requirements.

Managing agents need to have clear processes for pricing business and an audit trail to show how pricing will deliver the projected results within the approved business plan and how pricing will be managed over the relevant underwriting cycle.

The Corporation does not seek to eradicate the inherent risks of insurance risk from the market but to ensure that they are managed within a commercial and prudent underwriting environment. The key processes that provide assurance to the Franchise Board include:

- Reviewing and agreeing syndicate business plans and capital;
- Quarterly performance monitoring;
- Minimum standards compliance;
- New entrant approval;
- Risk governance; and
- Risk appetite monitoring.

Reserving risk

Reserving risk arises where the reserves established in the balance sheet are not adequate to meet eventual claims arising. The level of uncertainty varies significantly from class to class but can arise from inadequate reserves for known or Incurred but Not Reported Claims (IBNR). These shortfalls can arise from inadequate reserving processes or from the naturally uncertain progress of insurance events. Lloyd's current level of aggregate market reserves remains robust and the continued level of overall reserve releases are supported by underlying claims experience being more favourable than expected.

Syndicates set reserves and obtain an annual Statement of Actuarial Opinion ("SAO"). The SAO is produced under the guidance of the UK Actuarial Profession; the Lloyd's Actuary has close access to the relevant committees in the UK professional body and is able to ensure that the guidance is kept in line with Lloyd's objectives. The Lloyd's Actuary confirms to the PRA each year that every syndicate has been provided with an unqualified Statement of Actuarial Opinion and sets out any areas of uncertainty that have been identified.

Additional reserve monitoring exercises undertaken by Lloyd's include:

- Lloyd's makes projections at market level and in some cases at syndicate level;
- Relative Reserve Benchmarking, comparing reserve strength between syndicates;
- IBNR burn analysis;
- Large loss monitoring; and
- Setting Reserving Minimum Standards.

Catastrophe risk

Catastrophe risk is the risk of loss occurring across all lines of business from worldwide natural catastrophe events. Managing agents may use catastrophe modelling software, where appropriate, to monitor aggregate exposure to catastrophe losses. The Corporation has developed a suite of Realistic Disaster Scenarios to measure syndicate level and aggregate market exposure to both natural catastrophes and man-made losses. These are monitored frequently and syndicates supply projected probabilistic exceedance forecasts for Lloyd's key exposures with their capital and business plans. Further enhancements to the monitoring and oversight of aggregate market catastrophe risk exposure have been implemented within the approved internal model under Solvency II.

Lloyd's Realistic Disaster Scenarios (RDS) stress test the aggregation of risks at both an individual syndicate level and for the market as a whole. The event scenarios are regularly reviewed to ensure they represent material catastrophe risks.

C.2 Market risk

Market risk is the risk that the values of financial instruments will fluctuate because of movements in foreign currency, interest rates or asset values. Syndicate assets are held in premium trust funds (PTFs) and are subject to the asset rules contained in the PRA's handbook. Market risk can arise in respect of the investments held by syndicates, and centrally in respect of capital provided by members and assets held by the Society including the Central Fund.

Market risk represents the risk that movements in financial markets will affect the financial position of the Society. Market risks arising from the disposition of the Society's investments are monitored against defined parameters using Value at Risk (VAR) methodology. The position is reviewed regularly by the Investment Committee. Investments are actively monitored on a fair value basis and all investments are designated as fair value through profit or loss.

Managing agents manage asset risk through their investment strategy. There is greater oversight of market risk in light of the volatile economic climate, which includes the monitoring of Investment Management Minimum Standards. Assets are monitored across the full Lloyd's Chain of Security to ensure the asset disposition of the market and Corporation remains appropriate, closely monitoring global economic and market trends.

The potential financial impact of changes in market value is additionally monitored through the capital setting process, and asset mix must be reported to Lloyd's on a quarterly basis, including credit rating analysis of fixed income portfolios.

Market risk comprises three types of risk:
(a) currency risk;
(b) interest rate risk; and
(c) equity price risk.

<u>Currency risk</u>
Managing agents must identify the main currencies in which each syndicate transacts its business. For the market overall, the US dollar is the largest currency exposure. Assets are then held in each of those currencies to match the relevant liabilities. Managing agents must ensure that assets match liabilities and take corrective action where a mismatch arises. Lloyd's also reviews the matching of assets to liabilities at the syndicate level as well as at the market level.

<u>Interest rate risk</u>
Interest rate risk is the risk that the value and future cash flows of a financial instrument will fluctuate because of changes in interest rates. Lloyd's operates a

generally conservative investment strategy with material cash and short dated bonds portfolios, which reduces the interest rate risk exposure.

Equity price risk

Equity price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market. Equity price risk exposure relates to financial assets and financial liabilities whose values will fluctuate as a result of changes in market prices, principally investment securities. Such risks are managed by setting and monitoring objectives and constraints on investments, diversification plans and limits on investments in each sector and market. In aggregate there is no significant concentration of equity price risk.

C.3 Credit risk

Credit risk represents the risk of financial loss if a counterparty, or the issuer of a security, fails to meet its contractual obligations. The assets of syndicates, members' capital and Society assets are exposed to credit risk.

The market's principal credit risk is that the reinsurance purchased to protect the syndicate's gross losses does not respond as expected. This can occur because the reinsurer is unable to settle its liabilities. Managing agents are expected to have a clear and comprehensive plan for the reinsurance of each syndicate. This takes into account risk appetite for retained insurance risk and the potential for the accumulation of risk. The managing agent should monitor and assess the security of, and exposure to, each reinsurer and intermediary. Reinsurance credit risk is subject to quarterly review by Lloyd's.

Society assets are also exposed to credit risk. With regard to credit investments, Lloyd's performs further credit analysis and does not solely rely on external credit ratings as an indicator of investment eligibility. This includes a top-down approach (macroeconomic environment and cyclical outlook) and a bottom-up approach (business fundamentals, issuer analysis and security analysis).

C.4 Liquidity risk

Liquidity risk arises where there are insufficient funds to meet liabilities, particularly claims. This may affect assets held by syndicates, provided as members' capital and held by the Society.

Managing agents are expected to manage the cash needs of their syndicates on an ongoing basis and to avoid becoming forced sellers of assets. They are required to match the duration of their syndicates' investments with the liabilities to policyholders. Generally syndicates have a high concentration of liquid assets, namely cash and government securities.

The value and term of short-term assets are carefully monitored against those of the Society's liabilities. The Society maintains sufficient liquid assets to meet liabilities as they fall due. The liquidity of the Central Fund is monitored separately.

Lloyd's centrally monitors syndicate liquidity both in terms of asset mix and future funding needs and conducts stress tests to monitor the impact on liquidity of significant claims events.

C.5 Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Operational risk is modelled using a scenario analysis approach, generating operational loss scenarios in conjunction with business teams. This may arise at syndicate level and centrally.

Managing agents manage these risks through internal compliance monitoring and the use of detailed procedure manuals. Lloyd's sets minimum standards to be applied by agents and monitors to ensure these are met.

Syndicate SCRs calculated with internal models are also required to include a capital requirement in respect of operational risks. The methodology used will be different for each syndicate (as operations are different) but all syndicates are obliged to include their operational risk exposures within their internal model.

In addition elements of operational risk which arise as a result of syndicate operations but are not felt to be adequately captured in their internal models are modelled centrally. This is known as Additional Central Fund (ACF) risk.

C.6 Other material risks

Regulatory risk

Regulatory risk is the risk of loss owing to a breach of regulatory requirements or failure to respond to regulatory change. Managing agents monitor regulatory development to ensure ongoing compliance and any impact on claims reserves. Additionally, given current developments in the global regulatory landscape, the Corporation closely monitors changes which may adversely impact the global licence network. Lloyd's is actively working with the market to assist and adapt to the changes in the UK regulatory architecture, in particular the increased focus on conduct risk by the FCA; managing agents are now expected to comply with the Lloyd's Conduct Minimum Standards. Similarly, Lloyd's monitors global political trends and is taking action at both a Corporation and market level in response to a growing geopolitical risk facing companies operating around the world.

Group risk

Group risk is the risk of loss resulting from risk events arising within a related entity. While Lloyd's is not a group, the Corporation monitors potential risks which could impact Lloyd's, for example arising from the activities of a parent company of a syndicate or managing agent. Whilst, by its nature, group risk is difficult to control, the Corporation mitigates the potential impact of group risk through the implementation of controls, including Lloyd's minimum standards, mitigating any material impairment to Lloyd's brand, reputation or strategic priorities.

Concentration risk

Lloyd's closely monitors concentrations of risk across the market and tests risk exposure against clearly defined risk appetites as established by the Franchise Board. Specialist supervisory teams across Lloyd's monitor concentrations across the following areas: region-perils, class of business, geographical location, and method of distribution in insurance and investment counterparties, amongst others. Whilst syndicates define the type of business that they write, at the market level Lloyd's seek to avoid inappropriate concentration of premium sources, monitoring concentration of business in poorly performing classes, material sources of premium by method of placement as well as coverholder concentration, which feature in metrics reported quarterly to the Franchise Board. Managing agents controlling more than 10% of overall market gross written premium are also subject to Franchise Board review. Any reported metrics outside of appetite are reported to and discussed by the Risk Committee and Franchise Board. Specific and targeted actions can then be agreed, which will be discussed with specific managing agents or the market as a whole, as appropriate. These actions can vary considerably depending on the nature of the risk or the class of business impacted, with different levels of the requirements placed on syndicates, which forms part of Lloyd’s oversight role of the market.

<u>Prudent person principle</u>
In accordance with Article 132 of Directive 2009/138/EC, all assets at Lloyd’s are invested in accordance with the prudent person principle.

<u>Syndicate level assets</u>
Managing agents, as trustees, are responsible for the investment of their own syndicate PTFs. The members of the syndicate are the primary bearers of financial risk. Managing agents identify planned investment risk within the SCR and members are required to provide sufficient capital to support this risk. PTF investments must be managed in accordance with PRA requirements under the Prudent Person Principle. PTF investments must also comply with the Membership & Underwriting Requirements (M&URs) issued by Lloyd’s. Syndicates must submit information on investment returns and dispositions to Lloyd’s quarterly.

Syndicate investment data is analysed and assessed by Lloyd’s quarterly. Where a concern is identified at syndicate level, Lloyd’s may consider the issue in the context of the syndicate’s overall operations. Lloyd’s may engage with the managing agent to identify whether appropriate risk limits have been exceeded and, if so, may require investment dispositions to be amended, or more typically that additional capital be provided by members, as appropriate.

When reviewing syndicate submissions, Lloyd’s will have regard to its defined risk appetites. These specify that overall market risk (across all syndicates) should not exceed 20% of total syndicate risk, reflecting that the Lloyd’s market is primarily structured to take on and manage insurance risks, not investment risk. Wherever an individual syndicate plans or adopts more than 20% market risk, this is subject to specific review and approval by Lloyd’s.

Lloyd’s also considers periodically whether any additional rules should be adopted for prudential reasons beyond the PRA requirements of the Prudent Person Principle.

In extremis, if Lloyd’s identifies inappropriate risk by reference to the investments of all syndicate PTFs, in aggregate, it may constrain the investment dispositions of all syndicates by amending the M&URs.

<u>Member level capital (FAL)</u>
Each member of Lloyd’s is responsible for the investment of their own FAL and is the primary bearer of the resulting financial risk. Lloyd’s acts as trustee and custodian of FAL assets and reviews all transactions in advance of approving them for settlement. All FAL investments must comply with the PRA requirements under the Prudent Person Principle; additionally they must also comply with the Lloyd’s M&URs. Annually the processes for checking the assets for the solvency calculation are subject to an annual external audit.

FAL investment dispositions are analysed quarterly by Lloyd's. Where concerns are identified, Lloyd's may engage with members to understand risk strategies and may require that investment dispositions be amended. Where members do not comply with such requirements Lloyd's, in its capacity as trustee, may intervene to amend investment dispositions. Lloyd's may also require a member to maintain additional assets within their FAL if that member's FAL investments exceed defined risk limits. If Lloyd's identifies risks which are unacceptable when considering all FAL assets, or all FAL and PTF assets together, it may, in extremis, adjust permitted investments for all participants by amending the M&URs.

Lloyd's also considers periodically whether any additional rules should be adopted for prudential reasons beyond the PRA requirements of the Prudent Person Principle.

Central resources

Lloyd's complies with the Prudent Person Principle in respect of central resources by ensuring that:

- Lloyd's does not invest in investments that are not admitted to trading on a regulated financial market or to complex products which are difficult to value. Neither does it invest in investments which are not traded or traded on a non-regular basis.
- Lloyd's use of derivatives as a risk mitigating technique is currently limited to forward foreign exchange contracts and interest rate swaps. Effective risk transfer is obtained by transacting both these derivatives under Master International Swaps and Derivatives Association (ISDA) agreements with the derivative counterparties. Considerations of how the quality, security, liquidity or profitability of the Central Fund portfolio is improved without significant impairment of any of these features, with the use of interest rate swaps to facilitate efficient portfolio management is made by the Lloyd's Investment Committee before authorisation was given to trade these derivatives. The Lloyd's Investment Committee have also ensured that procedures have been implemented in line with this risk policy to monitor the performance of these derivatives and against defined risk limits.
- Before investing in securitised assets, the Corporation ensures that Lloyd's interests and the interests of the originator or sponsor concerning securitised assets are well understood and aligned. In addition Lloyd's ensures that such securities meet the new EU regulations of the minimum risk retention of 5% by the sponsor or are covered under grandfathering arrangements.

Stress testing

Lloyd's seeks to continuously identify and examine Stress and Scenario Tests (SSTs) which may have an adverse impact on the business model in order to ensure potential risks are clearly understood, monitored effectively and adequate controls are in place.

The outcomes/conclusions of the SSTs form an integral part of the overall risk management system and act as a prompt to senior management to take action across a range of areas such as: implementing changes to the LIM, re-evaluating risk appetites, reviewing the application of Franchise Guidelines, business plan decisions for syndicates and capital management decisions (e.g. setting Economic Capital).

C.7 Any other information

As reported on R0790 of template S.23.01 as shown in Appendix 1, the total of Expected Profit In Future Premiums (EPIFP) as at 31 December 2016 amounted to £1,934m.

Additional information on risk management at Lloyd's may be found at note 4 of the market results (pages 59 to 71) and pages 123 to 125 with respect to the Society within the Lloyd's Annual Report 2016, and note 3 'Risk Management' on pages 29 to 40 in the Aggregate Accounts 2016.

D Valuation for Solvency Purposes

Sections/items indicated with an asterisk (*) are **unaudited**.

A comparison of Lloyd's UK GAAP with Solvency II balance sheets is summarised in the following table:

	UK GAAP	Change	Solvency II
	£m	**£m**	**£m**
Assets			
Deferred tax assets	47	-	47
Investments	55,354	61	55,415
Loans and mortgages	224	(82)	142
Reinsurers' share of technical provisions	14,420	(7,138)	7,282
Deferred acquisition costs	4,278	(4,278)	-
Deposits to cedants	20	62	82
Insurance and reinsurance receivables	13,924	(10,845)	3,079
Receivables (trade, not insurance)	1,582	(243)	1,339
Cash and cash equivalents	12,292	(9,995)	2,297
Any other assets	285	(16)	269
Total assets	**102,426**	**(32,474)**	**69,952**
Liabilities			
Technical provisions	64,295	(64,295)	-
- Best estimate	-	43,414	43,414
- Risk margin*	-	3,019	3,019
Provisions other than technical provisions	15	6	21
Pension benefit obligations	231	-	231
Deposits from reinsurers	109	(4)	105
Deferred tax liabilities	8	-	8
Derivatives	81	17	98
Debts owed to credit institutions	173	1	174
Insurance and reinsurance payables	5,442	(3,891)	1,551
Payables (trade, not insurance)	2,605	(254)	2,351
Subordinated liabilities	-	933	933
Any other liabilities	870	(381)	489
Total liabilities	**73,829**	**(21,435)**	**52,394**
Net excess of assets over liabilities	**28,597**	**(11,039)**	**17,558**

A qualitative description of the reasons for differences between UK GAAP and Solvency II is set out at section D.1 (assets), D.2 (technical provisions) and D.3 (liabilities other than technical provisions).

D.1 Assets

Valuation of assets including differences between Solvency II and UK GAAP

Overview
Lloyd's requires each syndicate to prepare a Solvency II balance sheet in accordance with Solvency II valuation rules.

Members' FAL are valued at fair value and thus comply with Solvency II valuation principles.

Assets and liabilities of the Society of Lloyd's are valued in accordance with IFRS. Adjustments are made as necessary to reflect Solvency II valuation principles.

Recognition
Assets are recognised only when economic benefits are expected to be received in future.

Under Solvency II, future cash flows relating to insurance and reinsurance contracts are included in the measurement of technical provisions. However, overdue cash flows are treated as insurance receivables in the balance sheet. This is the same principle that Lloyd's has applied in the recognition of insurance receivables. Lloyd's has applied similar principles as those applied for insurance receivables in assessing recognition of reinsurance receivables. Amounts recoverable from reinsurers relating to claims paid have been included in the balance sheet as reinsurance receivables.

Derecognition
Assets are derecognised once they have been transferred to a third party i.e. substantially all risks and rewards are transferred.

Valuation methodology
Assets are valued at fair value and Solvency II allows two approaches in determining the value of assets i.e. mark to market, and where this is not feasible, mark to model.

Deferred tax assets
Deferred tax assets relate solely to the Society of Lloyd's. Deferred tax assets are recognised for all deductible temporary differences and unutilised tax losses to the extent that it is probable that taxable profits will be available against which the deductible temporary differences or tax losses can be utilised. Deferred tax is measured on an undiscounted basis at the rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantially enacted at the reporting date.

Investments
Most of Lloyd's investments i.e. premium trust funds, FAL and Central Fund assets are fixed income investments. These are mainly government bonds and corporate bonds. In addition significant amounts of equities are held, particularly within members' FAL and the Central Fund.

There are no material differences in the valuation of investments for Solvency II and UK GAAP. However, the allocation of accrued interest has been included within the relevant investment assets rather than in 'Any other assets'.

Government bonds
These are valued at market value i.e. based on quoted prices. These bonds are regularly traded and hence their prices are easily obtained. These prices are obtained from the custodians. However where these are not considered current, a tradable quote from a broker is sought.

Corporate bonds
Most of the corporate bonds are of very high quality i.e. BBB rating and above. These bonds are regularly traded and hence their prices are easily obtained. Similar to the government bonds, these are valued at market value, based on the quoted prices provided by the custodians. Similar to government bonds, where prices from custodians are deemed not to be fresh, a tradable quote from a broker is sought.

Equity and investment funds
Equity investments held by Lloyd’s are mainly listed and hence their prices are readily available. These are valued at market value based on the quoted prices provided by custodians.

Loans and mortgages
These consist of the following:

- Loans and mortgages to individuals – relating to recoverable Central Fund loans made to hardship members; and
- Other loans and mortgages – relating to syndicate investment assets classified as loans and mortgages other than ‘Loans and mortgages to individuals’ and ‘Loans on policies’.

These are initially recognised in the financial statements at amortised cost. There are no material differences in the valuation of the ‘loans and mortgages’ held by Lloyd’s for Solvency II compared with UK GAAP.

Deposits to cedants
These are deposits relating to reinsurance accepted business from syndicates. Solvency II requires that all assets should be measured at fair value. However, book value as per UK GAAP is used as a proxy for the fair value for Solvency II balance sheet purposes where the impact of discounting is not material because the balances are due within one year or amounts due in more than one year are not material.

Insurance and reinsurance receivables
Solvency II requires that all assets should be measured at fair value. Hence, these are valued at fair value by discounting expected cash flows using a risk free rate. However, book value as per UK GAAP is used as a proxy for the fair value for Solvency II balance sheet purposes where the impact of discounting is not material because the balances are due within one year or amounts due in more than one year are not material.

While determining the valuation amount, Lloyd’s has considered the recoverability of these balances; hence the amount recognised in the balance sheet is net of expected losses as a result of default.

There are no material differences in the valuation of ‘insurance and reinsurance receivables’ for Solvency II and UK GAAP. However, under Solvency II, future cash flows relating to insurance and reinsurance contracts are included in the measurement of technical provisions, excluding overdue cash flows which remain as insurance receivables in the balance sheet.

Receivables (trade, not insurance)
These are recognised at their book value using UK GAAP. As these assets will generally crystallise within one year no discounting is applied as this would be immaterial.

Cash and cash equivalents
'Cash and cash equivalents' comprise of cash in hand and demand deposits, together with short term, highly liquid investments that are readily convertible to a known amount of cash, and that are subject to an insignificant risk of change in value. These are short term investments with a maturity period of three months or less from the date of acquisition.

Cash in hand and demand deposits are valued at the amount held at the end of the year plus accrued interest at the end of the year, where applicable.

The value of letters of credit, guarantees and life policies provided within FAL, which represent ancillary own funds (see section E.1 below), and which are included in 'cash and cash equivalents' in the table in section D are excluded from the Solvency II balance sheet but are recognised at their Solvency II valuation as ancillary own funds in the own funds template. The underlying assets supporting the covenant & charge are excluded from the Solvency II balance sheet on a similar basis.

Any other assets
These are recognised at their book value. These include items such as prepayments and accrued income. As these assets will generally crystallise within one year no discounting is applied as this would be immaterial.

D.2 Technical provisions

Solvency II technical provisions by material line of business
The table below summarises the Solvency II technical provisions for the market by high-level class of business as at 31 December 2016:

Class	Gross best estimate	Net best estimate	Risk margin*	Total net technical provisions including risk margin
	£bn	£bn	£bn	£bn
Accident & Health	1.54	1.45	0.11	1.56
Aviation	2.31	1.47	0.12	1.59
Casualty Financial & Professional Lines	8.24	6.38	0.40	6.78
Casualty Other	10.07	8.05	0.56	8.61
Casualty Treaty	3.39	3.18	0.20	3.38
Energy	4.27	3.11	0.40	3.51
Marine	5.25	4.47	0.41	4.88
Property (Direct & Facultative)	4.11	3.91	0.33	4.24
Property Treaty	2.28	2.52	0.36	2.88
Specialty Other	1.95	1.59	0.13	1.72
Total	**43.41**	**36.13**	**3.02**	**39.15**

A summary of technical provisions by Solvency II line of business is provided in Appendix 1 on templates S.12.01 and S.17.01.

Calculation of technical provisions

The technical provisions are calculated in line with the prescribed Solvency II requirements as per Articles 76 to 86 of Directive 2009/138/EC. In particular, the value of technical provisions correspond to the current amount insurance and reinsurance undertakings would have to pay if they were to transfer their insurance and reinsurance obligations immediately to another insurance or reinsurance undertaking. The calculation of technical provisions makes use of and is consistent with information provided by the financial markets and generally available data on underwriting risks (market consistency).

The technical provisions are calculated by syndicates in accordance with Lloyd's Technical Provisions Guidance July 2015. The calculations are undertaken by individual syndicates with the calculation basis and assumptions made at this level. Across the market the following bases, methods and assumptions are most relevant:

- Provisions for future claims are the most material element of the technical provisions;
- Provisions for future claims are based on standard actuarial techniques for estimation of non-life insurance liabilities; and
- Assumptions relating to run-off patterns and loss ratios are material to the calculation of future claims provisions.

Level of uncertainty associated with the value of technical provisions*

Provisions for future claims are the most material and uncertain element of the technical provisions. The associated uncertainty of these provisions is assessed by all syndicates and also by the Corporation, using both quantitative techniques and qualitative commentary on sources of uncertainty. Consideration of the uncertainty is undertaken for each syndicate as part of their reserving processes. This will focus on the areas of particular uncertainty specific to each syndicate and involves statistical reserving techniques, sensitivity and scenario testing and consideration of large reserves associated with individual losses. This information is received and reviewed by Lloyd’s as part of SAO and Actuarial Function reporting. Centrally the Lloyd’s Actuarial Function assesses the uncertainty in aggregate market provisions via the same methodologies. Further assessment of quantitative uncertainty in the technical provisions is made as part of internal modelling at syndicate and Corporation level.

In addition to the quantification provided in the LIM, Lloyd’s also monitors sources of uncertainty using the Statement of Actuarial Opinion (SAO) process. Each syndicate is required to provide an opinion, given by an actuary with an appropriate Practising Certificate, on reserve sufficiency. As part of this opinion any key sources of uncertainty are required to be highlighted and quantified. For the 2016 year end the number of wordings is low compared to historical levels and most relate to the potential for movement caused by the Ogden discount rate change. The opinions were submitted prior to the actual rate change being announced.

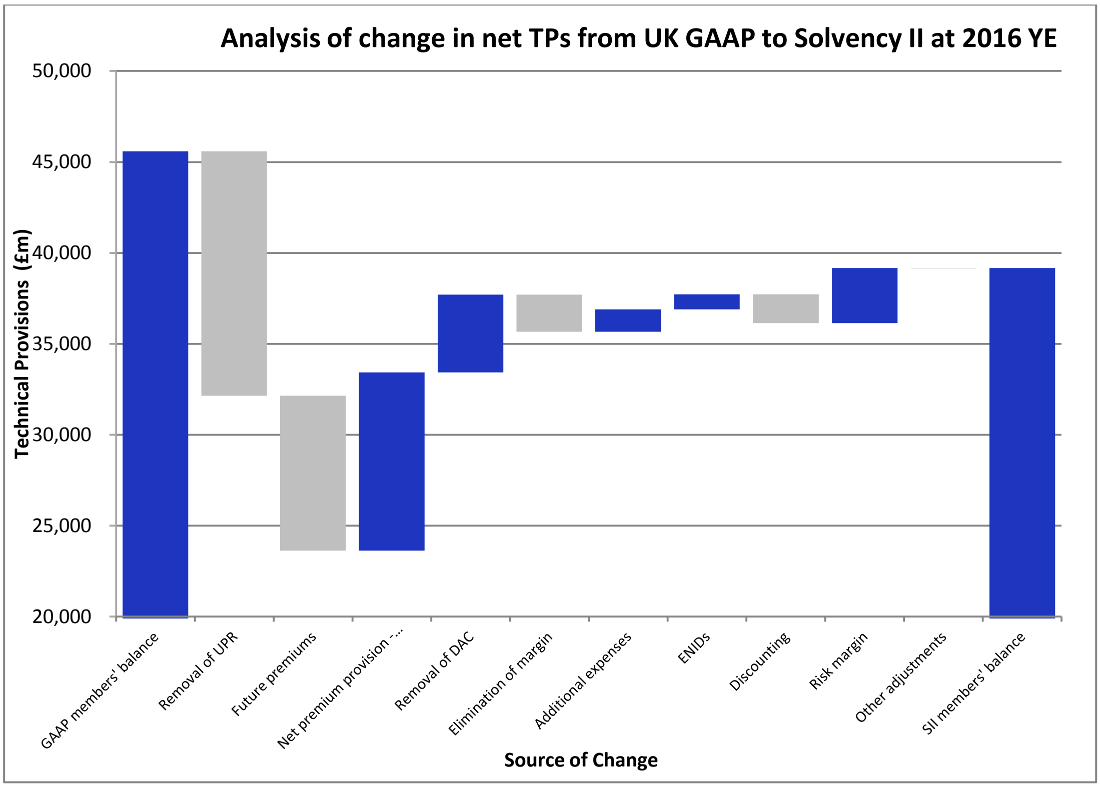
Valuation differences of technical provisions by material line of business between Solvency II and UK GAAP

The technical provisions on a Solvency II basis are calculated in line with Solvency II requirements. There are a number of significant differences between this calculation basis and the UK GAAP basis underlying the financial statements.

The material differences in the bases are summarised below:

- Removal of the requirements to hold an unearned premium reserve (UPR) and to allow for other non-monetary items;
- Movement to a cashflow basis for valuation of both gross business and outwards reinsurance. This means that future premium income is introduced into the technical provisions;
- The claims associated with the unearned business must also now be included, in place of the UPR provision;
- Removal of any implicit or explicit margins within technical provisions to give a "true best estimate" for solvency purposes, defined as the mean of the full range of all possible future outcomes;
- Inclusion of all expenses incurred in running-off the existing business, rather than only those relating to cost of claims administration;
- Introduction of the valuation of very low probability extreme events including latent claims, referred to as "Events not in Data" (ENIDs);
- Introduction of discounting of all reserves at risk-free rates, rather than discounting being related to expected investment income and only being allowable on particular claim types; and
- Inclusion of a risk margin sufficient to cover the expected cost of transfer of the obligations.

The impacts of the above changes for the 2016 year end are summarised in the chart below:



For Lloyd's the most material impact relates to the inclusion of future premium, though this is offset to an extent by future claims.

The UK GAAP and Solvency II net technical provisions by material line of business are summarised below:

Class	UK GAAP net technical provisions	Solvency II net technical provisions including risk margin*
	£bn	£bn
Accident & Health	1.96	1.56
Aviation	2.00	1.59
Casualty Financial & Professional Lines	7.62	6.78
Casualty Other	9.32	8.61
Casualty Treaty	3.30	3.38
Energy	3.81	3.51
Marine	6.07	4.88
Property (Direct & Facultative)	4.94	4.24
Property Treaty	3.75	2.88
Specialty Other	2.83	1.72
Total	**45.60**	**39.15**

Matching adjustment (per Article 77b of Directive 2009/138/EC)
Lloyd's does not permit the use of the matching adjustment by syndicates in the setting of technical provisions.

Volatility adjustment (per Article 77d of Directive 2009/138/EC)
Lloyd's does not permit the use of the volatility adjustment by syndicates in the setting of technical provisions.

Transitional risk-free interest rate-term structure (per Article 308c of Directive 2009/138/EC)
Lloyd's does not permit the use of the transitional risk-free interest rate-term structure by syndicates in the setting of technical provisions.

Transitional deduction (per Article 308d of Directive 2009/138/EC)
Lloyd's does not permit the use of the transitional deduction by syndicates in the setting of technical provisions.

Recoverables from reinsurance contracts and special purpose vehicles
The technical provisions are calculated gross, with reinsurance calculated separately under the same Solvency II principles. All existing and planned future reinsurance purchasing related to the gross provisions is included in the technical provision calculation and associated recoveries resulting from consideration of the expected value of all possible future outcomes is considered. As part of consideration of reinsurance recoveries an allowance for non-payment is also required.

Any material changes in assumptions for calculating technical provisions
This is the first year-end for which Solvency II technical provisions are the basis of reporting. These provisions have been reported to Lloyd's since 2012 and there are no material changes to the assumptions compared to those calculated at the previous year-end.

D.3 Other liabilities

Valuation of other liabilities including differences between Solvency II and UK GAAP
A quantitative summary by major class is provided at the start of section D above.

Provisions other than technical provisions
These are liabilities of uncertain timing or amount (excluding liabilities reported under 'Pension benefit obligations').

There are no material differences in the valuation of 'provisions other than technical provisions' for Solvency II and UK GAAP.

Pension benefit obligations
Lloyd's operates a number of defined benefit and defined contribution pension schemes. The principal scheme is the Lloyd's Pension Scheme which is a defined benefit scheme. Other schemes have been established for certain employees based overseas. These have been valued in accordance with IAS19 Employee Benefits.

Additional information in respect of pension scheme obligations may be found in note 12 'Pension schemes' in the Society accounts, on pages 158 to 163 of Lloyd's Annual Report 2016.

Deposits from reinsurers
These are syndicate related amounts received from reinsurers or deducted by the reinsurer according to the reinsurance contract.

Solvency II requires that all assets should be measured at fair value. Hence, these are valued at fair value by discounting expected cash flows using a risk free rate. However, book value as per UK GAAP is used as a proxy for the fair value for Solvency II balance sheet purposes where the impact of discounting is not material because the balances are due within one year or amounts due in more than one year are not material.

Deferred tax liabilities
Deferred tax liabilities relate solely to the Society of Lloyd's. Deferred tax is measured on an undiscounted basis at the rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantially enacted at the reporting date.

Derivatives
Derivatives have been valued at fair value for Solvency II purposes.

Debts owed to credit institutions
These are syndicate related debts such as mortgages, loans, and bank overdrafts owed to credit institutions (excluding bonds held by credit institutions).

Solvency II requires that all assets should be measured at fair value. Hence, these are valued at fair value by discounting expected cash flows using a risk free rate. However, book value as per UK GAAP is used as a proxy for the fair value for Solvency II balance sheet purposes where the impact of discounting is not material because the balances are due within one year or amounts due in more than one year are not material.

Insurance & reinsurance payables
Solvency II requires that all liabilities should be measured at fair value. Hence, these are valued at fair value by discounting expected cash flows using a risk free rate. However, book value as per UK GAAP is used as a proxy for the fair value for Solvency II balance sheet purposes where the impact of discounting is not material because the balances are payable within one year or amounts payable in more than one year are not material.

Payables (trade, not insurance)
These are recognised at their book value. As these liabilities will generally crystallise within one year no discounting is applied as this would be immaterial.

Subordinated liabilities
As at 31 December 2016, Lloyd's had two subordinated debt issues in place. Please refer to section E.1 for more details.

In the financial statements, using UK GAAP, the subordinated debt is initially recognised at fair value, being the fair value of the consideration received net of issue costs associated with the borrowing. After initial recognition, the subordinated debt is subsequently recorded at amortised cost using the effective interest rate over the period to the earliest option date. Amortised cost is calculated after taking into account issue costs and issue discount.

However the subordinated liabilities have been revalued at fair value for Solvency II purposes.

In the UK GAAP column of the table shown in section D above, the amount of the subordinated debt liability has been derecognised in accordance with the approach taken in Lloyd's Pro Forma Financial Statements on page 53 of the Lloyd's Annual Report 2016. The subordinated debt liability is recognised at fair value in the Solvency II column and then derecognised at this valuation on the own funds template.

Any other liabilities
These are recognised at their book value. As these liabilities will generally crystallise within one year no discounting is applied as this would be immaterial.

Leases
Payments made under operating leases are charged to the Society income statement on a straight-line basis over the period of the lease. Contractual capital expenditure is provided for over the term of the underlying lease agreement. The lease cost provision is an accounting estimate which arises due to the fact the Society has entered into a number of fully repairing leases.

Additional information on lease cost provisions for the Society is set out in note 22 of the Society accounts on page 175 of the Lloyd's Annual Report 2016.

D.4 Alternative methods for valuation

As described in section D.1 above, Lloyd's uses market value ie based on quoted prices from custodians to value investments such as government and corporate bonds. However where these are not considered current, a tradable quote from a broker is sought.

D.5 Any other information

There is no further material information to disclose.

E Capital Management

Sections/items indicated with an asterisk (*) are **unaudited**.

E.1 Own funds

Lloyd's SCR and central SCR*

The Society and the Lloyd's market are regulated by the PRA in accordance with the requirements of the Solvency II regime, which was implemented on 1 January 2016, as 'the association of underwriters known as Lloyd's'.

Lloyd's must calculate and cover two SCRs, given the unique structure of Lloyd's: the Lloyd's market wide SCR and the central SCR. Under the Solvency II regime, it must then ensure that each SCR is covered by eligible capital at all times.

The Lloyd's market wide SCR ("MWSCR") is calculated to cover all of the risks of 'the association of underwriters known as Lloyd's', i.e. those arising on syndicate activity, members' capital provided at Lloyd's and the Society taken together, at a 99.5% confidence level over a one year time horizon as provided for in Solvency II legislation. All of the capital of the component parts of the market taken together are available to meet the MWSCR.

The Lloyd's central SCR ("central SCR") is calculated in respect of only the risks facing the Society and the Central Fund at the same confidence level and time horizon used to calculate the MWSCR. The material risk is that members do not have sufficient funds to meet their underwriting losses even having complied with Lloyd's rigorous capital setting rules. In such an event assets from the Central Fund can, at the discretion of the Council, be made available to ensure that policyholders' claims are met. Only eligible capital held by the Society may be used to cover the central SCR.

The MWSCR and central SCR are both calculated in accordance with the Lloyd's Internal Model (LIM) which was approved by the PRA in December 2015.

Objectives, policies and processes for managing own funds

Lloyd's sets medium and long term financial objectives in accordance with among other things, its business objectives, the underwriting environment, broader economic conditions as well as the UK and global regulatory environment and future developments. This is articulated through Lloyd's risk management strategy and appetite, and in particular the Medium Term Capital Management Plan (MTCMP) and ORSA. Lloyd's Capital Management Policy has been designed to ensure that these objectives, once set, can be complied with through capital management.
The MTCMP is prepared to assist Lloyd's management in ensuring that it has sufficient capital centrally and across the Lloyd's market, in terms of both quantity and quality (tiering) to be able to meet its current and projected regulatory and economic capital requirements in the medium term (over a three year horizon). There have been no material changes to Lloyd's processes for managing own funds during 2016.

Ensuring minimum Tier 1 levels to cover the Lloyd's SCR

Under Solvency II, the SCR must be covered by at least 50% Tier 1 capital. As agreed with the PRA, this test applies to the Lloyd's SCR, which covers the 1 in 200 year loss to the 'association of underwriters known as Lloyd's' (as calculated using the LIM 'capital burn' test), as well applying a similar test to the central SCR which addresses the central capital requirement of the Society.

Most own funds at Lloyd’s are Tier 1 but as described below letters of credit (LOCs), guarantees and life policies provided as members’ FAL, FAL provided by covenant and charge, and the dated subordinated debt issued in 2014, constitute Tier 2 assets.

Lloyd’s has implemented a policy whereby the Lloyd’s SCR must be covered by at least 50% Tier 1 capital. Lloyd’s targets a coverage of the Lloyd’s SCR by at least 75% Tier 1 capital.

Lloyd’s monitors the composition of its capital in terms of amount and quality on an ongoing basis. Where coverage of this test becomes marginal then Lloyd’s has in place procedures to require members which make the greatest use of Tier 2 capital within their FAL to substitute part of this with Tier 1 capital. As at 31 December 2016, as reported on template S.23.01 in Appendix 1, Lloyd’s SCR of £17,200m was covered by £16,164m Tier 1 capital (94%).

The tiering test also applies to the central SCR. Lloyd’s applies similar procedures to monitor the quality of central capital in this respect.

There were no material changes in respect to the structure or quantum of Lloyd’s own funds, or of Lloyd’s processes and procedures in this respect, during 2016. As described in section E.6, Lloyd’s successfully issued a new Tier 2 subordinated debt instrument in January 2017 and intends to redeem the Tier 1 perpetual securities in June 2017.

Own funds classified by tier

A summary of Lloyd’s own funds is set out below. The total own funds available to meet the Lloyd’s SCR agrees to template S.23.01 R0500:

	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Syndicate assets	2,269			2,269
Members’ funds at Lloyd’s (FAL)	11,745	9,957		21,702
Society assets: Subordinated debt Deferred tax Balance of net assets	 398 1,752	 535 	 40 	 933 40 1,752
Total own funds available to meet the SCR	**16,164**	**10,492**	**40**	**26,696**
Lloyd’s SCR*				**17,200**
‘Excess’ own funds not eligible to meet SCR	-	1,892	40	1,932
Total own funds eligible to meet the SCR	**16,164**	**8,600**	**-**	**24,764**
Lloyd’s solvency ratio				**144%**

Total **available** own funds as at 31 December 2016 compared with 31 December 2015 are summarised below:

	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
31 December 2016	16,164	10,492	40	26,696
31 December 2015	13,586	9,930	24	23,540

The change in own funds during this period is primarily due to the surplus arising on Lloyd's activities in 2016. This is in line with a profit of £2,107m reported on page 52 of the 2016 Lloyd's annual report.

<u>Syndicate assets</u>
Syndicate assets are the aggregated own funds of all syndicates, net of anticipated profit releases and ring fenced funds. All syndicate assets are held in the form of on balance sheet items and meet the criteria of Tier 1 basic own funds.

<u>Members' FAL</u>
FAL provided in the form of cash and investments constitute on balance sheet items and meet the criteria of Tier 1 basic own funds.

A significant proportion of FAL is provided in ancillary own funds, in particular 'letters of credit and guarantees which are held in trust for the benefit of insurance creditors by an independent trustee and provided by credit institutions authorised in accordance with Directive 2006/48/EC' which are classified as Tier 2 ancillary own funds in accordance with Article 96 (2) of the Solvency II Directive. As described below, these ancillary own funds are subject to prior approval by the PRA and are reported as Tier 2 ancillary own funds in accordance with the valuation rules provided by the PRA's approval.

<u>Society assets</u>
As at 31 December 2016 Lloyd's had two subordinated debt issues in place:

- The perpetual subordinated capital securities issued in 2007 – treated as Tier 1 basic own funds in accordance with the Solvency II transitional rules for instruments issued before the application of Solvency II as set out in Article 308b (9) of Directive 2009/138/EC.
- The Sterling 2014 Notes issued in October 2014 – classified as Tier 2 basic own funds under Solvency II.

All other Society assets are classified as Tier 1 basic own funds, with the exception of deferred tax assets which are Tier 3 basic own funds.

<u>Reconciliation reserve</u>

The amount of the reconciliation reserve reported at R0760 of template S.23.01 (Appendix 1) is £706m. This is comprised of:

	£m	£m
Syndicate balances per PFFS[1] before deducting:	4,015	
- Solvency II valuation adjustments	(114)	
- Members' funds in syndicate (within R0730)	(3,315)	
- Foreseeable distributions (R0720)	(1,312)	
- Ring fenced funds (within R0740)	(320)	
		(1,046)
FAL per PFFS before deducting	21,703	
- Ancillary own funds at UK GAAP valuation	(9,958)	
- Other FAL (within R0730)	(11,745)	
		-
Society net resources per PFFS before deducting	2,879	
- Solvency II valuation adjustments	(34)	
- Subordinated debt (at fair value)	(933)	

- Deferred tax asset (within R0730)	(40)	
- Ring fenced funds (within R0740)	(120)	
		1,752
Total		**706**

[1] Pro Forma Financial Statements, page 53 of Lloyd's Annual Report 2016

Coverage of the Lloyd's SCR with eligible own funds

In accordance with Solvency II rules, the SCR must be covered with at least 50% Tier 1 own funds. Accordingly the amount of available own funds which exceeds 50% of the SCR is not eligible to cover the SCR and cannot be calculated as such in the solvency calculation.

This has a significant impact on Lloyd's solvency ratio calculation as a large part of Lloyd's capital is provided by ancillary own funds which are treated as Tier 2 capital for Solvency II purposes. However these are assets callable on demand. When called, the proceeds, namely cash, would qualify as Tier 1 capital. Under these circumstances, the additional £1,892 million of Tier 2 capital represented by these assets currently ineligible to meet the SCR (since they exceed the 50% tiering limit for Tier 2 and Tier 3 Capital set by Solvency II) would then become fully eligible.

Own funds available to meet the central SCR

	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Society assets: Subordinated debt Deferred tax Balance of net assets Callable layer	 398 1,752 708	 535 	 40 	 933 40 1,752 708
Total central own funds available to meet the SCR	**2,858**	**535**	**40**	**3,433**
Central SCR*				**1,600**
Total central own funds eligible to meet the SCR	**2,858**	**535**	**40**	**3,433**
Central solvency ratio				**215%**

Callable layer

The Society has the right to make a call on members of up to 3% of members' premium limits ("callable contributions"). The callable contributions can be drawn from members' premiums trust funds without the members' consent. This would result in the transfer of Tier 1 capital from syndicate funds to central resources. The value assigned to the callable layer has been reduced to reflect that part of the callable layer which would not be available in a stressed situation at the central SCR level of confidence.

Eligible amount of basic own funds to cover Minimum Capital Requirement, classified by tiers

The table below sets out Lloyd's eligible basic own funds to meet the MCR. The total agrees to template S.23.01 R0550:

	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Syndicate assets	2,269			2,269
Members' funds at Lloyd's	11,745			11,745
Society assets: Subordinated debt Balance of net assets excluding deferred tax	 398 1,752	 535		 933 1,752
Total basic own funds eligible to meet the MCR	**16,164**	**535**		**16,699**

Differences between equity as shown in the financial statements and the excess of assets over liabilities for solvency purposes

	Synds	FAL	Soc[1]	Total
	£m	£m	£m	£m
Capital, reserves and subordinated debt Per PFFS balance sheet (UK GAAP basis)[2]	4,015	21,703	2,879	28,597
Solvency II adjustments:				
Syndicate valuation adjustments	(114)			(114)
FAL valuation adjustments re ancillary own funds		(9,958)		(9,958)
Society assets not recognised for Solvency II purposes			(34)	(34)
Recognition of subordinated debt liability at fair value (subsequently derecognised on S.23.02 own funds template)			(933)	(933)
Solvency II excess of assets over liabilities (S.02.01.02 R1000)	**3,901**	**11,745**	**1,912**	**17,558**

[1] Society: Corporation and Central Fund (including subordinated debt)
[2] Lloyd's Pro Forma Financial Statements, page 53 of Lloyd's Annual Report 2016

Syndicate valuation adjustments
A key difference from the valuation basis for the financial statements (i.e. UK GAAP basis) compared to Solvency II is the valuation of technical provisions. This involves moving from the 'prudent undiscounted best estimate' basis of valuation used in UK GAAP to a market consistent basis of valuation based on a probability weighted best estimate (therefore stripping out surplus reserves held in syndicate accounts) less discounting for the time value of money, with a risk margin applied on top. In addition there are differences arising due to the recognition of contract boundaries and reinsurance costs.

Other valuation differences may arise in respect of investments (measured at fair value rather than amortised cost) and recognising the fair value of debtors and creditors due after one year (by discounting them where material for the time value of money).

In addition the managing agent profit commission must be recalculated as if it was charged on the Solvency II result.

As at 31 December 2016 the net valuation differences in this respect amounted to a negative adjustment of £114m.

FAL valuation adjustments regarding ancillary own funds (AOF)

FAL treated as ancillary own funds does not appear on the Solvency II balance sheet but instead the eligible amount in line with the valuation rules applied by the PRA is reflected in the own funds template S.23.02.

Accordingly £9,958m (in accordance with their UK GAAP valuations) has been derecognised on the Solvency II balance sheet:

AOF item	£m
Letters of credit and guarantees in accordance with Article 96 (2) of Directive 2009/138/EC	9,535
Life policies	25
FAL provided by covenant & charge	398
Total	**9,958**

Society assets not recognised for Solvency II purposes

The reduction to central assets for solvency purposes is summarised below:

Item	£m
Lloyd’s investments (Nelson collection) (due to uncertainty over fair value)	13
Plant & machinery (as not valued on a ‘fair value’ basis)	18
Provision for Centrewrite MCR (as Centrewrite’s assets are included in the aggregate Society accounts)	3
Total	**34**

Subordinated debt

The Lloyd’s Pro Forma Financial Statements (see page 53 of Lloyd’s 2016 annual report) derecognise the liability in respect of the subordinated debt in arriving at the £2,879m net resources reported above. This liability is recognised at the fair value of £933m in the Solvency II balance sheet before being subsequently derecognised at that value in the own funds template S.23.02.

The subordinated debt is comprised of the Sterling 2014 Notes and Perpetual Subordinated Capital Securities issued in 2007.

The Sterling 2014 Notes (‘Notes’) are subordinated obligations of the Society. Each tranche of the Notes will rank pari passu with the other in a winding-up of the Society. Upon the occurrence of any winding-up proceedings of the Society, payments on the Notes will be subordinated in right of payment to the prior payment in full of all other liabilities of the Society, except for liabilities which rank equally with or junior to the Notes. Payments on the Notes will also be subordinated to certain payments which may be made out of central assets including payments made to discharge the liabilities of an insolvent member to any person (including any policyholders) arising out of, or in connection with, insurance business carried on at Lloyd's by that insolvent member and payments made in respect of the costs required by or under any insolvency procedure to which the Society or the Lloyd's market may be subject. However, in the event of a winding-up of the Society, the claims of the holders of the Notes rank senior to the distribution of any central assets to members of Lloyd's generally (other than payments made to members in their capacity as senior creditors of the Society).

The Perpetual Subordinated Capital Securities ('capital securities') are subordinated obligations of the Society. Upon the occurrence of any winding-up proceedings of the Society, the claims of the holders of the capital securities will rank junior to all other claims of creditors of the Society (including any creditor who is the holder of any of the Sterling Notes issued by the Society in 2004) except for those creditors having claims which rank equally with or junior to the claims of the holders of the capital securities. The claims of the holders of the capital securities will also rank junior to any payments made to discharge the liabilities of a member in connection with insurance business carried on at Lloyd's by that member and also to the claims of any person in respect of whom a New Central Fund undertaking has been made. However, in the event of a winding-up of the Society, the claims of the holders of the capital securities rank senior to the distribution of any central assets to members of Lloyd's generally (other than payments made to members in their capacity as senior creditors of the Society).

<u>Basic own fund items subject to transitional arrangements referred to in Articles 308b(9) and 308b(10) of Directive 2009/138/EC</u>
The Perpetual Subordinated Capital Securities issued in 2007 are subject to the transitional arrangements referred to in Articles 308b(9) and 308b(10) of Directive 2009/138/EC. These securities were issued before the Solvency II rules relating to such instruments were applicable and thus, in accordance with the Solvency II transitional rules, are 'grandfathered' for 10 years from 1 January 2016 at the tiering levels in accordance with the previous supervisory regime. Accordingly they are treated as Tier 1 basic own funds. The first call date is at June 2017.

<u>Ancillary own funds – amount, method and counterparty details for items referred to in points (a), (b) and (c) of Article 89(1) of Directive 2009/138/EC</u>
A significant proportion of Lloyd's own funds are provided in the form of ancillary own funds (AOF) provided within members' FAL.

AOF is subject to prior supervisory approval before they may be treated as available capital under Solvency II. Consistent with this, Lloyd's submitted an application to the PRA for approval of AOF in November 2016. The PRA subsequently granted approval of this application on 19 December 2016, amounting in total to £9,889m. The approval including the conditions of subsequent valuations of AOF were published in the PRA's written notice 3676520. The approval applies until 1 January 2021.

As set out in the written notice, the PRA provided approval in respect of 1,684 letters of credit, bank guarantees and insurance company guarantees ('guarantee items'), 137 life policy items and one covenant & charge item. Details of each counterparty are not disclosed in the written notice or the SFCR as they represent confidential arrangements between the member concerned and the counterparty providing the AOF instrument.

If any of the AOF items are called they would be converted into cash, a Tier 1 basic own funds item.

The table below summarises Lloyd's AOF and the valuation of these as at 31 December 2016 consistent with the valuation rules contained within the PRA's most recent approval of these. These amounts appear on template S.23.01 provided in Appendix 1.

	Tier 2
	£m
Letters of credit and guarantees in accordance with Article 96 (2) of Directive 2009/138/EC	9,535
Life policies	24
FAL provided by covenant & charge	398
Total ancillary own funds	**9,957**

Letters of credit and guarantees in accordance with Article 96 (2) of Directive 2009/138/EC
Certain members provide capital in the form of letters of credit and guarantees held in trust by Lloyd's to support FAL. This form of capital is consistent with 'letters of credit and guarantees which are held in trust for the benefit of insurance creditors by an independent trustee and provided by credit institutions authorised in accordance with Directive 2006/48/EC' (which is treated as Tier 2 capital per Article 96 (2) of the Directive).

Letters of Credit (LOCs)
LOCs provided as FAL are in a Lloyd's standard form, and constitute a clean, irrevocable and unconditional standby credit which can be drawn down on demand. No substantive alterations to the form of the LOC can be made without consultation and notification to the PRA/FCA. Lloyd's has made conditions and requirements which must be met in order for a LOC to be admissible for FAL.

The parties to the LOC are Lloyd's (as beneficiary) and the approved credit institution. If the LOC has been confirmed by a UK credit institution (which would be the case if the issuing bank is outside of the UK) then Lloyd's contractual relationship will be with the confirming bank; if the LOC is not confirmed (because the issuing bank is in the UK), then Lloyd's contractual relationship will be with the issuing bank. Either way, both parties to the LOC will be in the UK. Moreover, all LOCs must be governed by English law and subject to the jurisdiction of the English court, as per the M&URs and the wording of the standard form LOC itself.

Some LOCs are provided on a syndicated basis, in which case Lloyd's would call on the agent bank. The contractual relationship is as described above.

Guarantees
Guarantees provided as FAL are in a Lloyd's prescribed form, which cannot be changed without consultation and notification to the PRA/FCA. Lloyd's has made conditions and requirements which must be met in order for a guarantee to be admissible for FAL. The process for drawing on a guarantee is slightly different to that for a LOC – the wording of the guarantee states that a demand can be made any time after the Principal (i.e. the member) is in default under the Security and Trust Deed under which the guarantee is held. The Principal would be in default if a demand for payment under the Trust Deed has been made and not met in accordance with its terms.

The parties to the guarantee are Lloyd’s (as beneficiary) and the issuing entity.

In order to issue a guarantee an entity must be approved by Lloyd’s – the criteria for approval include (inter alia) that a guarantee must be issued or confirmed out of London (although elsewhere in the UK (e.g. Manchester) has also been accepted). As with LOCs, this is a Lloyd’s requirement and the wording of the guarantee itself states that the guarantee is subject to English law and the exclusive jurisdiction of the English court.

Sometimes a joint guarantee is provided in which case Lloyd’s would call on the agent bank. The contractual relationship is as described above.

<u>Life policies</u>
Certain members provide FAL in the form of life policies. Lloyd’s sets out conditions for these to be eligible as FAL. These include that the policy is assigned to Lloyd’s, which is achieved through the execution by the member of a Deed of Assignment in favour of Lloyd’s. Notice of the assignment is then given by Lloyd’s to the life company which issued the policy, and acknowledgement of the same requested from the life company.

As a result of the assignment, the owner of the policy – as far as the life company is concerned – is Lloyd’s. The relevant parties to the arrangement are therefore Lloyd’s and the life company.

The life policies will be subject to the law of the jurisdiction in which they were issued, which in most cases will therefore be English law. In each case, Lloyd’s requires the life company to advise which local jurisdiction the company is governed to transact life assurance business, and also to confirm that it is authorised to transact such business in the UK. The deed of assignment by which the policies are transferred to Lloyd’s ownership are governed by English law and jurisdiction, and the assignment will have been acknowledged by the life company, and as such there are no concerns as to whether Lloyd’s has properly acquired the benefit of them.

<u>FAL provided by covenant and charge</u>
Certain members of Lloyd’s (only one as at 31 December 2016) provide funds at Lloyd’s (FAL) in the form of ‘covenant and charge’ (C&C). Under this arrangement, a fellow group company (the covenantor) of a corporate member provides a ‘covenant to pay’ up to a defined amount in favour of Lloyd's, the benefit of which is held by Lloyd’s as trustee of a Security and Trust Deed (Covenantor) between the covenantor, the corporate member and Lloyd’s. The covenant is secured by a fixed and floating charge (the Charge), pursuant to which the covenantor grants a first fixed charge in favour of Lloyd’s over a portfolio of assets equivalent in value to the amount of the covenant to pay, together with a floating charge over its entire undertaking.

<u>Items deducted from own funds and significant restrictions affecting availability and transferability of own funds</u>

<u>Foreseeable distributions</u>
The amount of £1,312m reported on R0720 ‘Foreseeable dividends, distributions and charges’ on template S.23.01 represents the net amount of distributions available for release outside of the Lloyd’s system to members in the capital test from April 2017. The capital test calculates the amount of funds that each member needs to be held at

Lloyd's to cover its capital requirement and any underwriting liabilities. Only any excess over this amount is available for release to the member.

Ring fenced funds
Ring fenced funds arise where an asset is not considered to be freely available to meet all liabilities and thus must be deducted from available own funds. There are two areas where this arises at Lloyd's, in respect of certain syndicate overseas trust funds and Lloyd's China.

Lloyd's has conducted a review of syndicate overseas trust funds to assess whether any constitute a ring fenced fund. Where this conclusion has been reached they are excluded from available own funds to meet the Lloyd's SCR. The amount in total in this respect is £320m.

The value of the investment in Lloyd's China has also been treated as a ring fenced fund as it is considered that these assets are not available to meet all Lloyd's insurance creditors on an unrestricted basis. The amount in total in this respect is £120m.

The total of these amounts of £440m is as reported on R0740 at template S.23.01 in Appendix 1.

E.2 Solvency Capital Requirement* and Minimum Capital Requirement

Amount of Solvency Capital Requirement* and Minimum Capital Requirement
The table below shows the total SCR and MCR as at 31 December 2016.

	£m
Lloyd's MWSCR*	17,200
Lloyd's MCR	7,253
Central SCR*	1,600

The final amounts of the Lloyd's MWSCR and central SCR are subject to supervisory assessment.

Solvency Capital Requirement split by risk categories*
The table below shows the risk categories that make up the Lloyd's MWSCR as at 31 December 2016:

Component Description	Amount
	£m
Reserving risk	3,421
All other (attritional) underwriting risk	6,008
Catastrophe risk	5,129
Market risk	293
Reinsurance credit risk	885
Operational risk	645
Pension risk	23
MWSCR before adjustments	**16,404**
Foreign exchange adjustment to reflect the strengthening of the US	796

dollar against sterling in the second half of 2016	
MWSCR	**17,200**

An analysis of the Lloyd's SCR by component as agreed with the PRA is provided at template S.25.03 (see Appendix 1).

Simplified calculations used in standard formula
Lloyd's SCR is calculated using an internal model thus this is not applicable to Lloyd's.

Undertaking specific parameters used in standard formula
Lloyd's SCR is calculated using an internal model thus this is not applicable to Lloyd's.

Option provided for in third subparagraph of Article 51(2) of Directive 2009/138/EC
Lloyd's SCR is calculated using an internal model thus this is not applicable to Lloyd's.

Impact of undertaking specific parameters required in accordance with Article 110 of Directive 2009/138/EC
Lloyd's SCR is calculated using an internal model thus this is not applicable to Lloyd's.

Inputs to calculate the Minimum Capital Requirement
The Lloyd's Minimum Capital Requirement has been calculated in accordance with the input elements as specified on template S.28.02 (see Appendix 1).

Changes to the SCR* and MCR during the reporting period
The MWSCR*, central SCR* and MCR as at 31 December 2016 and 31 December 2015 are summarised below:

	31 December 2016	31 December 2015
	£m	£m
MWSCR*	17,200	14,150
Central SCR*	1,600	1,450
MCR	7,253	6,151

Lloyd's conducts a substantial part of its business in US dollars. The main cause of the increase in the MWSCR is due to the significant strengthening of the US dollar against sterling during 2016. This has increased the sterling value of the US dollar denominated elements of the SCR. This has also caused the central SCR to increase.

The MCR is calculated formulaically based on premiums and technical provisions. The value of these has increased due to the exchange rate movement described above thus resulting in an increase to the MCR.

E.3 Use of the duration-based equity risk sub-module in the calculation of the Solvency Capital Requirement

Lloyd's has not used this in the calculation of the SCR.

E.4 Differences between the standard formula and any internal model used*

<u>Uses of Lloyd's Internal Model (LIM)</u>
The table below lists out the various purposes of the LIM

Use	Description
1. Calculate regulatory capital requirements for Lloyd's and the notional SCR at member level, and support Lloyd's regulatory reporting requirements	The LIM is used to calculate the Lloyd's and central SCRs. In addition, the LIM is used to calculate a notional SCR for each member used in the calculation of the member level reporting point as required by national specific template NS.13. However, in this case syndicates' one-year SCRs, once approved as described in use 3 below, are taken as the starting point and the member modeller tool within the LIM capital calculation kernel (CCK) is then used to allocate these to each member according to their participation on each syndicate and allowing for diversification between syndicates and years of account where relevant. The LIM is also used to support the regulatory reporting requirements, where the output of the model is used to satisfy Solvency II Pillar 3 requirements.
2. Support the annual and quarterly Lloyd's Society ORSA, including Stress and Scenario Testing	The ORSA is an ongoing process within Lloyd's culminating in an annual report to the Risk Committee and Franchise Board. It incorporates a series of processes which ensure an appropriate level and quality of capital is maintained to support the risks taken within Lloyd's on a current and future basis, in light of Lloyd's strategy set by the Franchise Board. The annual ORSA report pulls together information on the key risks, the capital and solvency position, stress and scenario testing and a forward looking assessment of Lloyd's capital needs. The LIM is used to produce some of this information, either under one of the other uses described here or specifically for the annual ORSA. The quarterly ORSA report, produced for the Risk Committee and the Franchise Board, combines information on the key risks with the capital and solvency position of Lloyd's. The LIM is used to produce some of this information; either through one of the other uses or specifically for the quarterly ORSA report.
3. Support approval of syndicate business and capital plans	The approval of syndicate business and capital plans is one of the main tools used to oversee the Lloyd's market. Syndicates submit a Syndicate Business Forecast (SBF) and a Lloyd's Capital Return (LCR) yearly in September. This is reviewed and approved by Lloyd's Capital and

Use	Description
	Planning Group (CPG). As part of the process the CCK, run in benchmark mode, is used to benchmark syndicate capital (both one-year and ultimate). Where syndicates' own capital figures differ materially from the benchmark the LIM is used to investigate the differences. The LIM component elements CCK, Lloyd's Catastrophe Model (LCM) and Lloyd's Investment Risk Model (LIRM) (see following section for further information) are all used to produce consistent and automated management information on each syndicate to support the business plan and capital recommendations. Where a syndicate is new and unable to produce an LCR in the first or second year of its existence, the benchmark figure is used to set capital for that syndicate. The benchmark for a new syndicate will usually be based on three years of business and include a new syndicate loading.
4. Market event impact analysis	The LIM is used to estimate the potential effect of an insurance event to the London Market. The Lloyd's Catastrophe Model (LCM) estimates gross claims from an event within the largest five region/perils. The LCM does not retain event level information when aggregating syndicates catastrophe risk into a Society view. However using syndicate event level data feeding into the LCM it is possible to calculate a Society estimate of the claims from an event.
5. Support monitoring of Lloyd's Society risk appetite	Lloyd's risk appetite is an articulation of the level of risk-taking which the Franchise Board deems to be acceptable for Lloyd's. The risk appetite framework is the key tool used to monitor Lloyd's risk profile at a market and Corporation level. Risk appetite statements have been defined for each material risk area and are split according to whether they are Market or Corporation risks. All risk appetite metrics are reported to the Risk Committee and Franchise Board as part of the quarterly or annual ORSA. A number of the risk appetite metrics are produced using output from the LIM.
6. Setting economic capital, at member and central level	The LIM is also used to calculate the Economic Capital Requirements for Lloyd's. This is done at both central and member level. Lloyd's bases these calculations on an SCR 'to ultimate' ie reflecting uncertainty in the run-off of liabilities to extinction, rather than the regulatory one year time horizon. <u>Member level</u>: Once syndicates' ultimate SCR figures have been approved (see use 3) these are used as the basis for setting member economic capital requirements. The Economic Capital Uplift (ECU) is applied to

Use	Description
	syndicates' SCRs and the member modeller tool within the LIM CCK is then used to allocate this amount to each member according to their participation on each syndicate and allowing for diversification between syndicates and years of account where relevant. Central level: The central Economic Capital Requirement is calculated using the central SCR, to ultimate, as a base. A series of adjustments are then made to arrive at an assessment of an 'economic' central capital requirement.
7. Monitor and manage catastrophe exposures	The LCM provides a probabilistic view of Lloyd's Catastrophe risk, estimating Lloyd's gross, net and final net (net plus reinstatements) loss to the material natural catastrophes for the Lloyd's Market. Summary data from the LCM is presented quarterly to the Executive Committee in the Management Information Park. This is used to monitor the aggregate market catastrophe risk and to assist in the review of syndicate's compliance within Lloyd's Minimum standards with respect to Exposure Management.
8. Monitor and manage investment risk for Central Fund assets	Central Fund assets are invested centrally by Treasury & Investment Management (LTIM) and LIRM is one of the primary tools used to support the management of investment risk for this portfolio. The Central Fund risk appetite is expressed in the form of a value at risk (VAR) budget. LIRM is used to calculate VAR on a monthly basis, allowing LTIM to monitor and report on asset risk against appetite. LIRM is also used as a tool to inform and support investment decisions on an ad-hoc basis particularly where changes in strategy may have a material impact on portfolio level VAR.
9. Manage operational risk	This use supports two main areas: 1) Operational risk scenarios approved by the Corporation Risk Committee informs the central SCR 2) Oversight of Corporation operational risk by the Corporation Risk Committee.

Scope of internal model in terms of business units and risk categories
The scope of Lloyd's internal model can be categorised into three areas:

- Syndicate risks;
- Member risks; and
- Corporation risks.

Syndicate risks
Syndicates are the source of the majority of risks. They source all of the insurance business; manage the bulk of the asset portfolios; hold the majority of the counterparty exposures; and conduct most of the operational day-to-day operational activity.

The syndicate risks include:

- Insurance risk;
- Reserve risk;
- Underwriting risk;
- Natural catastrophe risk (“catastrophe risk”);
- All other risks (“attritional risk”);
- Market risk on syndicate assets (including credit risk on Premiums Trust Funds);
- Liabilities;
- Market risk;
- Credit risk;
- Syndicate operational risk; and
- Liquidity risk.

<u>Member risks</u>
Members provide capital (FAL), in a variety of forms to support syndicates’ risks; and present asset related risks which are dependent on characteristics of assets used to meet their FAL.

Members are exposed to market risk (including credit risk) on FAL.

<u>Corporation risks</u>
Central level risks include:

- Member deficits – arising from syndicate risks including Additional Central Fund risk (ACF);
- Central operational risk;
- Market risk (including credit risk) on central assets; and
- Pension fund risk resulting in deficit requiring funding from central assets.

<u>Integration of the techniques to integrate any partial internal model with the standard formula</u>
The LIM is a full internal model so this is not applicable.

<u>Methods used for the calculation of the probability distribution forecast and the Solvency Capital Requirement</u>
The LIM includes components and processes that are material to the risk and capital calculation within Lloyd’s. It consists of three main component models:

- Capital Calculation Kernel (CCK);
- Lloyd’s Catastrophe Model (LCM); and
- Lloyd’s Investment Risk Model (LIRM).

The main element of the LIM is the Capital Calculation Kernel (CCK) which drives the capital calculation. It is a fully integrated Monte-Carlo simulation based stochastic model. The model is run with 100,000 simulations to ensure stability of results.
The CCK represents the entire Lloyd’s marketplace and models all material quantifiable risk types that the market is exposed to. These risks are modelled using Monte-Carlo simulation methods and are drawn together using the structure of the Lloyd’s market. This allows the impacts of these risks to be quantified for different entities in the market place, namely syndicates, members and Central Fund.

The CCK builds a specific representation of each syndicate from the ground up using a generic structure, within a framework of dependency which determines how much diversification there is within and between syndicates. The generic structure calculates stochastic technical provisions, P&L, and balance sheet for the end of the

12 month period ‘on risk’. The CCK then models how risk flows through the “chain of security”, i.e. from syndicates to members to the Central Fund.

Insurance risk is modelled separately for attritional risk and natural catastrophe risk. For attritional risks, insurance losses are simulated by class of business and allocated to insurance risk for each syndicate after allowing for syndicate noise. Syndicate noise is an additional random factor applied to allow for diversification between syndicates and the syndicates’ different class of business experience which will be more volatile compared to the market as a whole. As a result, syndicates will have different results and higher volatility than the market.

The catastrophe risk is defined by simulated losses imported from the LCM. Syndicate noise is not applied to natural catastrophe losses as the LCM captures syndicate variability and differences between syndicates directly. The LCM’s core purpose is to take syndicate Exceedance Probability (EP) curves and produce an aggregated Lloyd’s view of natural catastrophe risk. The LCM aggregates losses across scenarios and applies loadings to ensure complete coverage of risks (e.g. uplifts for European windstorm clustering, secondary uncertainty and non-modelled risks) to produce the aggregated Lloyd’s market view. For each simulation in the CCK, a scenario is picked at random for each of the five major perils, plus Rest of the World (“RoW”) risks.

The LIRM models market risks as part of the LIM and consists of three core sub-components:

- Economic Scenario Generator (ESG) - an external model provided by Towers Watson, which produces consistent stochastic scenarios of economic and financial variables;
- Asset Model - defines assets to be modelled, re-investment rules of the assets and calculates the distribution of total return for defined assets; and
- Portfolio Model - defines asset portfolios by combining modelled assets.

Once all loss types are aggregated in the LIM, if syndicate losses exceed Premiums Trust Funds (PTF) then the excess is allocated to members. If member losses exceed their FAL then the excess becomes a loss to the Central Fund. Risks relating to the Central Fund which are not considered at syndicate level are also added (operational, market risk on central assets and pension risk) to produce a central capital requirement.

<u>Differences between standard formula and internal model</u>

The LIM is a fully-integrated stochastic model. This method of calculating capital requirements is fundamentally different to the standard formula approach of deterministically combining stresses.

The LIM considers the unique nature and structure of the Lloyd’s Market and the detailed risks to which it is exposed, which the standard formula is not able to do. This includes:

- Insurance Risk - Profit in plan: The standard formula makes no allowance for any expected profits in business plans (which can be significant);
- Catastrophe Risk: Allowance for catastrophe risk uses a combination of shocks and scenarios in the standard formula which is significantly less sophisticated than the LIM (and syndicate internal models);
- Market risk: The LIM (and most syndicates) use Economic Scenario Generators (ESGs) to determine their market risk compared to the shocks applied to assets and own funds in the standard formula;

- Diversification: the standard formula gives credit for diversification within each syndicate only (across class, geographical area and risk component. The LIM models the diversification across the market both within and between syndicates which have different exposures;
- Structure: The Standard Formula does not capture the unique capital structure of Lloyd's and cannot provide a Central Fund capital requirement.

<u>Risk measure and time period used in the internal model</u>
As set out in Article 101(3) of Directive 2009/138/EC, the SCR calculated using the internal model corresponds to the 99.5^{th} Value-at-Risk over a one year period.

<u>Nature and appropriateness of data used in the internal model</u>
The LIM uses various sources of data; this data is both internal (based on analyses performed by Lloyd's) and external. Data used within the internal model is subject to the Lloyd's Data Quality Management Policy which requires checks and controls to be applied to the data. The purpose of this policy is to allow data owners to attest that it is accurate, appropriate and complete.

Data is subject to an annual order of all controls and any associated risks arising from its use.

E.5 Non-compliance with the Minimum Capital Requirement and non-compliance with the Solvency Capital Requirement*

Lloyd's has met the Lloyd's SCR, central SCR and MCR throughout the reporting period.

E.6 Any other information

Lloyd's successfully issued £300m of new Tier 2 subordinated debt in January 2017. Furthermore, Lloyd's has provided notice to noteholders of the 2007 Perpetual Subordinated Capital Securities ('grandfathered' at Tier 1 as described above) that these shall be redeemed in June 2017, the first call date.

Appendix 1

S.02.01.02

Balance sheet

All figures shown in GBP '000

		Solvency II value
		C0010
Assets		
Goodwill	R0010	
Deferred acquisition costs	R0020	
Intangible assets	R0030	0
Deferred tax assets	R0040	47,558
Pension benefit surplus	R0050	0
Property, plant & equipment held for own use	R0060	0
Investments (other than assets held for index-linked and unit-linked contracts)	R0070	55,414,734
Property (other than for own use)	R0080	0
Holdings in related undertakings, including participations	R0090	6,596
Equities	R0100	2,832,873
Equities - listed	R0110	2,742,618
Equities - unlisted	R0120	90,255
Bonds	R0130	38,929,709
Government Bonds	R0140	15,829,635
Corporate Bonds	R0150	20,322,660
Structured notes	R0160	42,425
Collateralised securities	R0170	2,734,989
Collective Investments Undertakings	R0180	12,699,576
Derivatives	R0190	74,780
Deposits other than cash equivalents	R0200	871,201
Other investments	R0210	0
Assets held for index-linked and unit-linked contracts	R0220	0
Loans and mortgages	R0230	141,528
Loans on policies	R0240	0
Loans and mortgages to individuals	R0250	43,410
Other loans and mortgages	R0260	98,118
Reinsurance recoverables from:	R0270	7,282,008
Non-life and health similar to non-life	R0280	7,159,965
Non-life excluding health	R0290	7,076,591
Health similar to non-life	R0300	83,374
Life and health similar to life, excluding health and index-linked and unit-linked	R0310	122,044
Health similar to life	R0320	22,016
Life excluding health and index-linked and unit-linked	R0330	100,028
Life index-linked and unit-linked	R0340	0
Deposits to cedants	R0350	81,918
Insurance and intermediaries receivables	R0360	1,563,542
Reinsurance receivables	R0370	1,514,977
Receivables (trade, not insurance)	R0380	1,339,485
Own shares (held directly)	R0390	0
Amounts due in respect of own fund items or initial fund called up but not yet paid in	R0400	0
Cash and cash equivalents	R0410	2,297,098
Any other assets, not elsewhere shown	R0420	268,860
Total assets	**R0500**	69,951,709

Liabilities		
Technical provisions – non-life	R0510	45,937,918
Technical provisions – non-life (excluding health)	R0520	45,038,110
Technical provisions calculated as a whole	R0530	0
Best Estimate	R0540	42,135,150
Risk margin	R0550	2,902,960
Technical provisions - health (similar to non-life)	R0560	899,808
Technical provisions calculated as a whole	R0570	0
Best Estimate	R0580	833,922
Risk margin	R0590	65,886
Technical provisions - life (excluding index-linked and unit-linked)	R0600	495,647
Technical provisions - health (similar to life)	R0610	58,216
Technical provisions calculated as a whole	R0620	0
Best Estimate	R0630	55,962
Risk margin	R0640	2,254
Technical provisions – life (excluding health and index-linked and unit-linked)	R0650	437,431
Technical provisions calculated as a whole	R0660	0
Best Estimate	R0670	389,295
Risk margin	R0680	48,136
Technical provisions – index-linked and unit-linked	R0690	0
Technical provisions calculated as a whole	R0700	0
Best Estimate	R0710	0
Risk margin	R0720	0
Other technical provisions	R0730	
Contingent liabilities	R0740	0
Provisions other than technical provisions	R0750	21,071
Pension benefit obligations	R0760	230,518
Deposits from reinsurers	R0770	104,766
Deferred tax liabilities	R0780	7,665
Derivatives	R0790	98,011
Debts owed to credit institutions	R0800	174,031
Financial liabilities other than debts owed to credit institutions	R0810	4,551
Insurance & intermediaries payables	R0820	604,212
Reinsurance payables	R0830	947,073
Payables (trade, not insurance)	R0840	2,350,328
Subordinated liabilities	R0850	932,605
Subordinated liabilities not in Basic Own Funds	R0860	0
Subordinated liabilities in Basic Own Funds	R0870	932,605
Any other liabilities, not elsewhere shown	R0880	484,555
Total liabilities	**R0900**	52,392,950
Excess of assets over liabilities	**R1000**	17,558,758

S.05.01.02

Premiums, claims and expenses by line of business
All figures shown in GBP '000

S.05.01.02.01

Non-Life (direct business/accepted proportional reinsurance and accepted non-proportional reinsurance)

		Line of Business for: non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance)												Line of Business for: accepted non-proportional reinsurance				Total
		Medical expense insurance	Income protection insurance	Workers' compensation insurance	Motor vehicle liability insurance	Other motor insurance	Marine, aviation and transport insurance	Fire and other damage to property insurance	General liability insurance	Credit and suretyship insurance	Legal expenses insurance	Assistance	Miscellaneous financial loss	Health	Casualty	Marine, aviation, transport	Property	
		C0010	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0120	C0130	C0140	C0150	C0160	C0200
Premiums written																		
Gross - Direct Business	R0110	329,897	714,931	176,779	461,007	597,487	4,278,730	6,925,435	6,099,269	782,271	103,147	13,644	195,791					20,678,388
Gross - Proportional reinsurance accepted	R0120	35,567	103,515	15,806	15,043	6,099	647,497	1,497,610	595,228	166,312	-64	30	10,363					3,093,007
Gross - Non-proportional reinsurance accepted	R0130													516,665	1,139,662	1,332,540	3,674,624	6,663,491
Reinsurers' share	R0140	79,305	110,809	37,346	64,611	118,919	1,305,907	1,978,240	1,358,766	285,636	32,505	205	38,559	103,147	169,758	378,844	1,273,441	7,335,997
Net	R0200	286,159	707,637	155,239	411,439	484,667	3,620,320	6,444,806	5,335,731	662,946	70,579	13,469	167,595	413,518	969,904	953,697	2,401,183	23,098,889
Premiums earned																		
Gross - Direct Business	R0210	312,639	702,767	165,432	481,520	581,469	4,418,162	6,686,962	5,601,219	676,902	99,202	16,662	182,886					19,925,822
Gross - Proportional reinsurance accepted	R0220	36,281	105,289	16,242	44,439	17,491	737,213	1,482,996	571,273	174,468	4	12	8,472					3,194,181
Gross - Non-proportional reinsurance accepted	R0230													515,094	1,097,225	1,392,866	3,612,558	6,617,742
Reinsurers' share	R0240	73,335	106,255	27,567	95,402	124,879	1,299,358	1,898,941	1,260,563	232,215	30,460	240	35,944	93,923	161,833	381,685	1,224,344	7,046,944
Net	R0300	275,585	701,800	154,106	430,557	474,081	3,856,017	6,271,018	4,911,930	619,156	68,747	16,435	155,414	421,170	935,393	1,011,180	2,388,214	22,690,802
Claims incurred																		
Gross - Direct Business	R0310	165,693	353,876	154,108	439,627	440,064	2,542,050	3,596,226	3,363,377	482,173	38,720	12,513	101,997					11,690,424
Gross - Proportional reinsurance accepted	R0320	44,288	50,959	16,966	33,714	15,514	418,197	864,853	386,684	90,760	3,262	3	5,866					1,931,068
Gross - Non-proportional reinsurance accepted	R0330													196,151	808,134	791,834	1,395,788	3,191,908
Reinsurers' share	R0340	42,189	48,648	31,991	205,221	164,456	893,044	857,503	972,502	171,899	21,019	918	19,000	26,711	106,180	236,690	365,166	4,163,136
Net	R0400	167,791	356,187	139,084	268,121	291,122	2,067,204	3,603,576	2,777,559	401,035	20,963	11,597	88,864	169,441	701,954	555,145	1,030,622	12,650,264
Changes in other technical provisions																		
Gross - Direct Business	R0410	0	0	0	0	0	0	0	0	0	0	0	0					0
Gross - Proportional reinsurance accepted	R0420	0	0	0	0	0	0	0	0	0	0	0	0					0
Gross - Non-proportional reinsurance accepted	R0430													0	0	0	0	0
Reinsurers' share	R0440	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Net	R0500	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Expenses incurred	R0550	136,915	349,611	74,093	168,810	208,372	1,669,102	2,846,800	2,141,714	272,665	52,919	4,698	75,012	155,337	330,272	381,290	913,588	9,781,196
Other expenses	R1200																	74,914
Total expenses	R1300																	9,856,109

S.05.01.02.02

Life

		Line of Business for: life insurance obligations						Life reinsurance obligations		Total
		Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance	Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations	Health reinsurance	Life-reinsurance	
		C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0300
Premiums written										
Gross	R1410	0	0	0	99,182	0	0	0	2,527	101,709
Reinsurers' share	R1420	0	0	0	11,694	0	0	0	267	11,961
Net	R1500	0	0	0	87,488	0	0	0	2,260	89,748
Premiums earned										
Gross	R1510	0	0	0	98,900	0	0	0	3,849	102,749
Reinsurers' share	R1520	0	0	0	10,266	0	0	0	1,035	11,301
Net	R1600	0	0	0	88,635	0	0	0	2,813	91,448
Claims incurred										
Gross	R1610	0	0	0	55,110	15,313	51,103	0	-4,740	116,786
Reinsurers' share	R1620	0	0	0	3,238	3,253	-4,978	0	-2,571	-1,057
Net	R1700	0	0	0	51,872	12,060	56,081	0	-2,169	117,843
Changes in other technical provisions										
Gross	R1710	0	0	0	0	0	0	0	0	0
Reinsurers' share	R1720	0	0	0	0	0	0	0	0	0
Net	R1800	0	0	0	0	0	0	0	0	0
Expenses incurred	R1900	0	0	0	44,111	103	256	0	2,088	46,558
Other expenses	R2500									0
Total expenses	R2600									46,558

S.05.02.01

Premiums, claims and expenses by country

All figures shown in GBP '000

S.05.02.01.01 — **Home Country - non-life obligations**

S.05.02.01.02 — **Top 5 countries (by amount of gross premiums written) - non-life obligations**

S.05.02.01.03 — **Total Top 5 and home country - non-life obligations**

		Home country - United Kingdom	USA	Canada	Australia	Bermuda	Japan	Total Top 5 and home country
		C0080	C0090	C0091	C0092	C0093	C0094	C0140
Premiums written								
Gross - Direct Business	R0110	9,371,872	6,101,814	1,036,041	666,120	79,420	74,558	17,329,826
Gross - Proportional reinsurance accepted	R0120	1,360,887	850,767	30,958	37,473	42,216	49,112	2,371,414
Gross - Non-proportional reinsurance accepted	R0130	3,136,923	1,628,390	125,762	137,554	54,018	103,070	5,185,715
Reinsurers' share	R0140	3,420,163	2,022,559	252,312	185,141	34,078	53,487	5,967,739
Net	R0200	10,449,518	6,558,412	940,449	656,007	141,577	173,253	18,919,216
Premiums earned								
Gross - Direct Business	R0210	9,211,274	5,847,883	942,908	632,524	65,910	69,798	16,770,297
Gross - Proportional reinsurance accepted	R0220	1,408,452	912,836	33,053	40,768	24,284	44,236	2,463,629
Gross - Non-proportional reinsurance accepted	R0230	3,176,742	1,578,251	129,514	135,983	56,529	97,728	5,174,747
Reinsurers' share	R0240	3,364,132	1,938,063	239,022	177,047	31,317	50,255	5,799,835
Net	R0300	10,432,336	6,400,908	866,454	632,228	115,406	161,506	18,608,838
Claims incurred								
Gross - Direct Business	R0310	5,154,646	3,063,158	658,201	422,659	23,762	36,294	9,358,720
Gross - Proportional reinsurance accepted	R0320	905,763	477,172	19,924	24,052	19,167	25,793	1,471,871
Gross - Non-proportional reinsurance accepted	R0330	1,598,725	599,823	150,114	82,362	25,847	42,078	2,498,949
Reinsurers' share	R0340	2,068,205	917,137	188,259	119,091	19,809	24,839	3,337,340
Net	R0400	5,590,930	3,223,016	639,980	409,981	48,968	79,325	9,992,199
Changes in other technical provisions								
Gross - Direct Business	R0410	0	0	0	0	0	0	0
Gross - Proportional reinsurance accepted	R0420	0	0	0	0	0	0	0
Gross - Non-proportional reinsurance accepted	R0430	0	0	0	0	0	0	0
Reinsurers' share	R0440	0	0	0	0	0	0	0
Net	R0500	0	0	0	0	0	0	0
Expenses incurred	R0550	4,431,431	2,849,355	398,242	242,159	51,887	59,629	8,032,703
Other expenses	R1200							65,230
Total expenses	R1300							8,097,933

S.05.02.01.04 — **Home Country - life obligations**

S.05.02.01.05 — **Top 5 countries (by amount of gross premiums written) - life obligations**

S.05.02.01.06 — **Total Top 5 and home country - life obligations**

		Home country - United Kingdom	USA	Norway	Italy	Mexico	Switzerland	Total Top 5 and home country
		C0220	C0230	C0231	C0232	C0233	C0234	C0280
Premiums written								
Gross	R1410	73,846	14,962	2,966	2,944	692	1,131	96,542
Reinsurers' share	R1420	10,523	1,024	73	134	33	23	11,810
Net	R1500	63,323	13,938	2,893	2,810	660	1,107	84,732
Premiums earned								
Gross	R1510	76,800	12,720	3,170	2,598	777	892	96,957
Reinsurers' share	R1520	9,945	956	73	114	38	23	11,149
Net	R1600	66,856	11,763	3,097	2,484	739	869	85,808
Claims incurred								
Gross	R1610	94,227	16,717	469	227	0	114	111,753
Reinsurers' share	R1620	107	-1,210	12	-7	0	1	-1,097
Net	R1700	94,120	17,927	457	233	0	113	112,850
Changes in other technical provisions								
Gross	R1710	0	0	0	0	0	0	0
Reinsurers' share	R1720	0	0	0	0	0	0	0
Net	R1800	0	0	0	0	0	0	0
Expenses incurred	R1900	30,215	8,822	1,955	1,398	285	786	43,461
Other expenses	R2500							0
Total expenses	R2600							43,461

S.12.01.02
Life and Health SLT Technical Provisions
All figures shown in GBP '000

			Index-linked and unit-linked insurance			Other life insurance						Health insurance (direct business)					
		Insurance with profit participation		Contracts without options and guarantees	Contracts with options or guarantees		Contracts without options and guarantees	Contracts with options or guarantees	Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations	Accepted reinsurance	**Total (Life other than health insurance, incl. Unit-Linked)**		Contracts without options and guarantees	Contracts with options or guarantees	Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Health reinsurance (reinsurance accepted)	**Total (Health similar to life insurance)**
		C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0150	C0160	C0170	C0180	C0190	C0200	C0210
Technical provisions calculated as a whole	R0010																0
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole	R0020										0				0		0
Technical provisions calculated as a sum of BE and RM																	
Best Estimate																	
Gross Best Estimate	R0030						30,733		355,889	2,673	389,295				55,962		55,962
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0080						-11,208		113,778	-2,542	100,028				22,016		22,016
Best estimate minus recoverables from reinsurance/SPV and Finite Re - total	R0090	0		0	0		41,941	0	242,111	5,215	289,267		0	0	33,946	0	33,946
Risk Margin	R0100					5,180			42,535	421	48,136				2,254		2,254
Amount of the transitional on Technical Provisions																	
Technical Provisions calculated as a whole	R0110										0						0
Best estimate	R0120										0						0
Risk margin	R0130										0						0
Technical provisions - total	R0200		0			35,913			398,424	3,094	437,431	0			58,216	0	58,216

S.17.01.02
Non-Life Technical Provisions
All figures shown in GBP '000

		Direct business and accepted proportional reinsurance												Accepted non-proportional reinsurance				
		Medical expense insurance	Income protection insurance	Workers' compensation insurance	Motor vehicle liability insurance	Other motor insurance	Marine, aviation and transport insurance	Fire and other damage to property insurance	General liability insurance	Credit and suretyship insurance	Legal expenses insurance	Assistance	Miscellaneous financial loss	Non-proportional health reinsurance	Non-proportional casualty reinsurance	Non-proportional marine, aviation and transport reinsurance	Non-proportional property reinsurance	**Total Non-Life obligation**
		C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0120	C0130	C0140	C0150	C0160	C0170	C0180
Technical provisions calculated as a whole	R0010																	
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole	R0050																	
Technical provisions calculated as a sum of BE and RM																		
Best estimate																		
Premium provisions																		
Gross	R0060	11,057	-31,361	34,816	179,484	105,181	142,525	548,054	586,085	-28,514	3,427	4,105	-1,466	-16,916	71,893	-21,007	-245,708	1,341,655
Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0140	1,234	-59,356	-2,115	2,243	27,049	-265,217	-517,540	-327,440	-70,928	998	237	-6,579	-16,504	-43,013	-101,325	-493,121	-1,871,378
Net Best Estimate of Premium Provisions	R0150	9,823	27,995	36,931	177,241	78,132	407,743	1,065,594	913,525	42,415	2,429	3,867	5,113	-412	114,905	80,318	247,413	3,213,034
Claims provisions																		
Gross	R0160	109,828	613,111	530,565	1,405,761	327,426	7,306,802	5,510,125	14,255,713	822,346	61,452	9,236	117,688	388,336	4,336,830	2,835,086	2,997,110	41,627,417
Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0240	12,240	69,977	116,775	627,612	96,744	2,127,140	961,675	3,207,994	168,566	14,896	1,728	17,397	22,587	428,715	771,349	385,950	9,031,343
Net Best Estimate of Claims Provisions	R0250	97,589	543,134	413,790	778,149	230,681	5,179,662	4,548,450	11,047,720	653,780	46,556	7,508	100,292	365,749	3,908,115	2,063,738	2,611,160	32,596,074
Total Best estimate - gross	R0260	120,885	581,750	565,381	1,585,246	432,607	7,449,328	6,058,179	14,841,798	793,833	64,879	13,341	116,222	371,420	4,408,722	2,814,079	2,751,402	42,969,072
Total Best estimate - net	R0270	107,412	571,130	450,721	955,390	308,814	5,587,405	5,614,044	11,961,245	696,195	48,985	11,376	105,405	365,338	4,023,020	2,144,056	2,858,574	35,809,108
Risk margin	R0280	10,020	42,675	32,112	41,962	25,680	397,560	446,764	987,603	88,617	3,382	604	11,439	30,540	361,173	180,591	308,125	2,968,846
Amount of the transitional on Technical Provisions																		
Technical Provisions calculated as a whole	R0290																	
Best estimate	R0300																	
Risk margin	R0310																	
Technical provisions - total																		
Technical provisions - total	R0320	130,905	624,426	597,493	1,627,208	458,287	7,846,888	6,504,943	15,829,401	882,449	68,260	13,944	127,661	401,960	4,769,895	2,994,670	3,059,528	45,937,919
Recoverable from reinsurance contract/SPV and Finite Re after the adjustment for expected losses due to counterparty default - total	R0330	13,473	10,621	114,660	629,856	123,793	1,861,922	444,135	2,880,553	97,638	15,893	1,965	10,817	6,083	385,702	670,023	-107,171	7,159,965
Technical provisions minus recoverables from reinsurance/SPV and Finite Re - total	R0340	117,432	613,805	482,834	997,352	334,494	5,984,965	6,060,808	12,948,847	784,811	52,367	11,979	116,844	395,878	4,384,193	2,324,647	3,166,699	38,777,954

S.19.01.21
Non-life insurance claims
All figures shown in GBP '000

Gross Claims Paid (non-cumulative) - Development year (absolute amount)

		0	1	2	3	4	5	6	7	8	9	10 & +
		C0010	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110
Prior	R0100											459,350
N-9	R0160	1,246,297	3,311,701	2,350,849	1,441,033	864,802	720,171	539,173	371,552	291,844	190,873	
N-8	R0170	2,121,984	3,928,308	2,792,076	1,541,730	1,156,482	740,665	739,575	423,679	227,721		
N-7	R0180	1,267,983	3,584,798	2,224,537	1,260,796	872,142	631,818	656,459	196,303			
N-6	R0190	1,860,399	4,672,883	3,799,645	2,177,288	1,403,644	1,058,496	635,851				
N-5	R0200	2,446,804	4,467,854	3,264,354	1,981,472	1,221,825	724,467					
N-4	R0210	1,479,465	3,831,461	2,976,478	1,851,012	1,108,549						
N-3	R0220	1,454,493	3,900,160	3,189,229	1,580,167							
N-2	R0230	1,220,829	4,053,831	3,223,329								
N-1	R0240	1,058,144	4,318,771									
N	R0250	1,366,778										

		In Current year	Sum of years (cumulative)
		C0170	C0180
Prior	R0100	459,350	459,350
N-9	R0160	190,873	11,328,296
N-8	R0170	227,721	13,672,220
N-7	R0180	196,303	10,694,836
N-6	R0190	635,851	15,608,206
N-5	R0200	724,467	14,106,776
N-4	R0210	1,108,549	11,246,966
N-3	R0220	1,580,167	10,124,049
N-2	R0230	3,223,329	8,497,989
N-1	R0240	4,318,771	5,376,915
N	R0250	1,366,778	1,366,778
Total	R0260	14,032,160	102,482,381

Gross undiscounted Best Estimate Claims Provisions - Development year (absolute amount)

		0	1	2	3	4	5	6	7	8	9	10 & +
		C0200	C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0290	C0350
Prior	R0100											3,857,959
N-9	R0160										979,282	
N-8	R0170									1,205,782		
N-7	R0180								717,552			
N-6	R0190							1,891,428				
N-5	R0200						2,274,365					
N-4	R0210					3,839,129						
N-3	R0220				4,584,754							
N-2	R0230			7,606,746								
N-1	R0240		10,292,258									
N	R0250	6,151,190										

		Year end (discounted data)
		C0360
Prior	R0100	3,662,454
N-9	R0160	942,691
N-8	R0170	1,150,331
N-7	R0180	666,253
N-6	R0190	1,812,610
N-5	R0200	2,182,359
N-4	R0210	3,700,400
N-3	R0220	4,406,556
N-2	R0230	7,313,065
N-1	R0240	9,902,900
N	R0250	5,887,798
Total	R0260	41,627,417

S.23.01.01
Own funds
All figures shown in GBP '000

S.23.01.01.01

Own funds

		Total	Tier 1 - unrestricted	Tier 1 - restricted	Tier 2	Tier 3
		C0010	C0020	C0030	C0040	C0050
Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35						
Ordinary share capital (gross of own shares)	R0010					
Share premium account related to ordinary share capital	R0030					
Initial funds, members' contributions or the equivalent basic own - fund item for mutual and mutual-type undertakings	R0040	15,060,015	15,060,015		0	
Subordinated mutual member accounts	R0050					
Surplus funds	R0070					
Preference shares	R0090					
Share premium account related to preference shares	R0110					
Reconciliation reserve	R0130	706,850	706,850			
Subordinated liabilities	R0140	932,605		397,725	534,880	0
An amount equal to the value of net deferred tax assets	R0160	39,893				39,893
Other own fund items approved by the supervisory authority as basic own funds not specified above	R0180					
Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds						
Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds	R0220					
Deductions						
Deductions for participations in financial and credit institutions	R0230					
Total basic own funds after deductions	R0290	16,739,363	15,766,865	397,725	534,880	39,893
Ancillary own funds						
Unpaid and uncalled ordinary share capital callable on demand	R0300					
Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand	R0310					
Unpaid and uncalled preference shares callable on demand	R0320					
A legally binding commitment to subscribe and pay for subordinated liabilities on demand	R0330					
Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	R0340	9,533,816			9,533,816	
Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	R0350					
Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	R0360					
Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	R0370					
Other ancillary own funds	R0390	422,455			422,455	
Total ancillary own funds	R0400	9,956,271			9,956,271	
Available and eligible own funds						
Total available own funds to meet the SCR	R0500	26,695,634	15,766,865	397,725	10,491,151	39,893
Total available own funds to meet the MCR	R0510	16,699,470	15,766,865	397,725	534,880	
Total eligible own funds to meet the SCR	R0540	24,764,590	15,766,865	397,725	8,600,000	0
Total eligible own funds to meet the MCR	R0550	16,699,470	15,766,865	397,725	534,880	
SCR	R0580	17,200,000				
MCR	R0600	7,253,191				
Ratio of Eligible own funds to SCR	R0620	1.4398				
Ratio of Eligible own funds to MCR	R0640	2.3024				

S.23.01.01.02

Reconciliation reserve

		C0060
Reconciliation reserve		
Excess of assets over liabilities	R0700	17,558,758
Own shares (held directly and indirectly)	R0710	
Foreseeable dividends, distributions and charges	R0720	1,312,000
Other basic own fund items	R0730	15,099,908
Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	R0740	440,000
Reconciliation reserve	R0760	706,850
Expected profits		
Expected profits included in future premiums (EPIFP) - Life business	R0770	29,628
Expected profits included in future premiums (EPIFP) - Non-life business	R0780	1,904,064
Total Expected profits included in future premiums (EPIFP)	R0790	1,933,692

S.25.03.21

Solvency Capital Requirement - for undertakings on Full Internal Models

All figures shown in GBP '000

S.25.03.01.01

Component-specific information

Unique number of component	Components Description	Calculation of the Solvency Capital Requirement
C0010	C0020	C0030
10300I	Other interest rate risk	526,619
10400I	Equity risk	1,965,806
10700I	Spread risk	2,316,354
10900I	Currency risk	5,474,786
11000I	Other market risk	2,531,035
19900I	Diversification within market risk	-7,507,520
20100I	Type 1 counterparty risk (reinsurance credit risk)	1,111,437
20310I	Other counterparty risk (asset default)	1,805,971
29900I	Diversification within counterparty risk	-953,129
30000I	Total life underwriting risk (sum of syndicate's life SCRs)	300,000
40800I	Health NSLT medical expenses	205,041
40900I	Health NSLT income protection	373,672
41000I	Health NSLT worker's compensation	104,345
41100I	Health NSLT non-proportional reinsurance	197,124
49900I	Diversification within health underwriting risk	-202,496
50150I	Premium risk	7,202,627
50210I	Reserve risk	7,217,237
50300I	Non-life catastrophe risk : natural (i.e. meteorological and geological)	9,319,312
59900I	Diversification within non-life underwriting risk	-9,490,151
70100I	Operational risk	644,864
80100I	Other risks including pension risk, ACF, FX adjustment and casualty addon	2,148,184

S.25.03.01.02

Calculation of Solvency Capital Requirement

		C0100
Total undiversified components	R0110	25,291,118
Diversification	R0060	-8,091,118
Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC (transitional)	R0160	
Solvency capital requirement excluding capital add-on	R0200	17,200,000
Capital add-ons already set	R0210	
Solvency capital requirement	R0220	17,200,000
Other information on SCR		
Amount/estimate of the overall loss-absorbing capacity of technical provisions	R0300	
Amount/estimate of the overall loss-absorbing capacity ot deferred taxes	R0310	
Total amount of Notional Solvency Capital Requirements for remaining part	R0410	17,084,000
Total amount of Notional Solvency Capital Requirement for ring fenced funds	R0420	116,000
Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios	R0430	
Diversification effects due to RFF nSCR aggregation for article 304	R0440	

S.28.02.01
Minimum Capital Requirement - Both life and non-life insurance activity
All figures shown in GBP '000

S.28.02.01.01

MCR components

		MCR components	
		Non-life activities	Life activities
		$MCR_{(NL, NL)}$ Result	$MCR_{(NL, L)}$Result
		C0010	C0020
Linear formula component for non-life insurance and reinsurance obligations	R0010	7,221,603	

S.28.02.01.02

Background information

		Background information			
		Non-life activities		Life activities	
		Net (of reinsurance/ SPV) best estimate and TP calculated as a whole	Net (of reinsurance) written premiums in the last 12 months	Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance) written premiums in the last 12 months
		C0030	C0040	C0050	C0060
Medical expense insurance and proportional reinsurance	R0020	109,927	251,614		
Income protection insurance and proportional reinsurance	R0030	577,225	697,912		
Workers' compensation insurance and proportional reinsurance	R0040	450,807	245,572		
Motor vehicle liability insurance and proportional reinsurance	R0050	955,732	547,619		
Other motor insurance and proportional reinsurance	R0060	309,048	463,767		
Marine, aviation and transport insurance and proportional reinsurance	R0070	5,594,704	3,803,346		
Fire and other damage to property insurance and proportional reinsurance	R0080	5,666,715	6,302,588		
General liability insurance and proportional reinsurance	R0090	12,033,551	5,098,330		
Credit and suretyship insurance and proportional reinsurance	R0100	717,693	703,135		
Legal expenses insurance and proportional reinsurance	R0110	49,248	60,838		
Assistance and proportional reinsurance	R0120	11,394	33,775		
Miscellaneous financial loss insurance and proportional reinsurance	R0130	105,781	150,952		
Non-proportional health reinsurance	R0140	368,994	235,449		
Non-proportional casualty reinsurance	R0150	4,023,045	958,799		
Non-proportional marine, aviation and transport reinsurance	R0160	2,165,917	1,043,967		
Non-proportional property reinsurance	R0170	2,926,388	2,589,386		

S.28.02.01.03

Linear formula component for life insurance and reinsurance obligations

		Non-life activities	Life activities
		$MCR_{(L, NL)}$ Result	$MCR_{(L, L)}$ Result
		C0070	C0080
Linear formula component for life insurance and reinsurance obligations	R0200		31,588

S.28.02.01.04

Total capital at risk for all life (re)insurance obligations

		Non-life activities		Life activities	
		Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk	Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk
		C0090	C0100	C0110	C0120
Obligations with profit participation - guaranteed benefits	R0210			0	
Obligations with profit participation - future discretionary benefits	R0220			0	
Index-linked and unit-linked insurance obligations	R0230			0	
Other life (re)insurance and health (re)insurance obligations	R0240			323,328	
Total capital at risk for all life (re)insurance obligations	R0250				35,426,386

S.28.02.01.05

Overall MCR calculation

		C0130
Linear MCR	R0300	7,253,191
SCR	R0310	17,200,000
MCR cap	R0320	7,740,000
MCR floor	R0330	4,300,000
Combined MCR	R0340	7,253,191
Absolute floor of the MCR	R0350	3,162
Minimum Capital Requirement	R0400	7,253,191

S.28.02.01.06

Notional non-life and life MCR calculation

		Non-life activities	Life activities
		C0140	C0150
Notional linear MCR	R0500		
Notional SCR excluding add-on (annual or latest calculation)	R0510		
Notional MCR cap	R0520		
Notional MCR floor	R0530		
Notional Combined MCR	R0540		
Absolute floor of the notional MCR	R0550		
Notional MCR	R0560		

pwc

Independent Reasonable Assurance Report of PricewaterhouseCoopers LLP to the Council of Lloyd's

Report on the preparation of relevant elements of the Solvency Financial Condition Report under Pillar 3 of Solvency II for the association of underwriters known as Lloyd's as at 31 December 2016.

Conclusion

In our opinion the Council of Lloyd's has prepared the information subject to assurance in the relevant elements of the Solvency Financial Condition Report (as defined below) under Pillar 3 of Solvency II for the association of underwriters known as Lloyd's ('Lloyd's') as at 31 December 2016, defined below, in all material respects in accordance with the reporting basis of preparation (the 'Lloyd's basis of preparation').

This opinion is to be read in the context of what we say in the remainder of this report.

What we have assured

Except as noted below, we have assured the 'Relevant elements of the Solvency and Financial Condition Report', which is prepared by the Council of Lloyd's, comprises:

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of the Lloyd's as at 31 December 2016 , ('the Narrative Disclosures subject to reasonable assurance'); and

- Lloyd's templates S.02.01.02, S.12.01.02, S.17.01.02 , S.23.01.01 and S.28.02.01 ('the Templates subject to reasonable assurance')

The relevant elements of the Solvency and Financial Condition Report have been compiled in part from an aggregation of financial information extracted from the corresponding Solvency II information included in syndicates' Annual Solvency Return by the managing agent of each syndicate, which have been submitted to the Council of Lloyd's and on which the auditors of each syndicate have reported. Our work did not involve assessing the quality of those audits or performing any audit procedures over the financial or other information of the syndicates or provided by the managing agents of the syndicates.

Professional standards applied and level of assurance

We performed a reasonable assurance engagement in accordance with International Standard on Assurance Engagements 3000 (Revised) – 'Assurance Engagements other than Audits and Reviews of Historical Financial Information', issued by the International Auditing and Assurance Standards Board (IAASB).

Our examination has consisted principally of:

- obtaining an understanding of the process used by the Council of Lloyd's to compile the relevant elements of the Solvency and Financial Condition Report from the financial records of the Society of Lloyd's, of Funds at Lloyd's and from the audited syndicate annual solvency returns, prepared by the managing agent of each syndicate;

- checking (on a sample basis) that the financial information included in the Relevant elements of the Solvency and Financial Condition Report for syndicates was correctly extracted from the audited syndicate annual solvency return;

- checking (on a sample basis) that the financial information included in the Relevant elements of the Solvency and Financial Condition Report for the Society of Lloyd's was correctly extracted from the Society of Lloyd's IFRS financial statements, and that adjustments were made by Lloyd's for presentation and classification differences between IFRS and Solvency II, in line with the Lloyd's basis of preparation;

- checking (on a sample basis) that the financial information included in the relevant elements of the Solvency and Financial Condition Report for Funds at Lloyd's was correctly extracted from the Lloyd's Pro Forma Financial Statements (the 'PFFS'), and that adjustments were made by Lloyd's for presentation and classification differences between the basis of preparation of the PFFS and Solvency II, in line with the Lloyd's basis of preparation; and

- evaluating evidence (on a sample basis) to support the completeness and accuracy of management's reconciliation of the Ancillary Own Funds in the relevant elements of the Solvency and Financial Condition Report to the amounts approved by the PRA in its letter to Lloyd's dated 19 November 2017.

Other Information

We are not required to assure, nor have we assured and as a consequence do not express an opinion on the 'Other Information' which comprises:

- Information contained within the relevant elements of the Solvency and Financial Condition Report set out above which are, or derive from the Solvency Capital Requirement, as identified in Appendix 1 to this report;
- The 'Summary', 'Business and performance', 'System of governance' and 'Risk profile' elements of the Solvency and Financial Condition Report; and
- Lloyd's templates S05.01.02, S05.02.01, S.19.01.21 and S.25.03.21;
- The written acknowledgement by management of their responsibilities, including for the preparation of the Solvency and Financial Condition Report ('the Responsibility Statement').

To the extent the information subject to assurance in the relevant elements of the Solvency and Financial Condition Report includes amounts that are totals, sub-totals or calculations derived from the Other Information, we have relied without verification on the Other Information.

Lloyd's has authority to calculate its Solvency Capital Requirement using an internal model ('the Model') approved by the Prudential Regulation Authority in accordance with the Solvency II Regulations. In forming our opinion (and in accordance with PRA Rules), we are not required to assure the inputs to, design of, operating effectiveness of and outputs from the Model, or whether the Model is being applied in accordance with the Company's application or approval order.

Our assurance does not extend to information in respect of earlier periods or to any other information included in the Lloyd's Solvency and Financial Condition Report within which the relevant elements of the Solvency and Financial Condition Report as at 31 December 2016 are included.

In accordance with Rule 4.1 (3) of the External Audit Part of the PRA Rulebook for Solvency II firms we are required to read the Other Information (as defined below) and consider whether it is materially inconsistent with the relevant elements of the Solvency and Financial Condition Report and our knowledge obtained in the reasonable assurance engagement over the Solvency and Financial Condition Report and of Lloyd's pro forma financial statements. If, based on the work we have performed, we conclude that there is a material misstatement of this Other Information, we are required to report that fact. We have nothing to report in this regard.

Our Independence and Quality Control

We applied the Institute of Chartered Accountants in England and Wales (ICAEW) Code of Ethics, which includes independence and other requirements founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

We apply International Standard on Quality Control (UK & Ireland) 1 and accordingly maintain a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Responsibilities for the relevant elements of the Solvency and Financial Condition Report and the reasonable assurance engagement

Our responsibilities and those of the Council of Lloyd's

The purpose of the Solvency and Financial Condition Report is to allow the Council of Lloyd's to report the solvency position of the association of underwriters known as Lloyd's in accordance with the requirements of Solvency II.

The Council of Lloyd's is responsible for the preparation of the Solvency and Financial Condition Report, including its basis of preparation, in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations which have been modified by the modifications, and supplemented by the approvals and determinations made by the PRA under section 138A of FSMA, the PRA Rules and Solvency II regulations on which they are based, as detailed below:

- Approval of items of ancillary own funds;
- Approval to use an internal model; and
- Modification of External Audit rule 4.1 for Lloyd's to obtain a reasonable assurance opinion in accordance with International Standard on Assurance Engagements 3000 (Revised) – 'Assurance Engagements other than Audits and Reviews of Historical Financial Information', issued by the International Auditing and Assurance Standards Board (IAASB).

The Council of Lloyd's is also responsible for designing and implementing an appropriate basis of preparation for this purpose and for such internal control as they determine is necessary to enable the preparation of a Solvency and Financial Condition Report that is free from material misstatement, whether due to fraud or error.

Our responsibility is to express an opinion about whether the preparation of the Relevant elements of the Solvency and Financial Condition Report has been performed by the Council of Lloyd's on the basis set out in Lloyd's basis of preparation.

Intended users and purpose

This report including our opinion has been prepared solely to the Council of Lloyd's in accordance with our engagement letter dated 18 May 2017 (the "instructions") to assist the Council of Lloyd's to comply with its obligations under External Audit rule 2.1 of the Solvency II firms Sector of the PRA Rulebook and for no other purpose. We do not, in providing this report, accept or assume responsibility for any other purpose or to any other party save where expressly agreed by our prior consent in writing.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants
London
19 May 2017

Appendix 1 – relevant elements of the Solvency and Financial Condition Report that are not subject to reasonable assurance

The relevant elements of the Solvency and Financial Condition Report that are not subject to reasonable assurance comprise:

- The following elements of template S.02.01.02:
  - Row R0550: Technical provisions - non-life (excluding health) - risk margin
  - Row R0590: Technical provisions - health (similar to non-life) - risk margin
  - Row R0640: Technical provisions - health (similar to life) - risk margin
  - Row R0680: Technical provisions - life (excluding health and index-linked and unit-linked) - risk margin
  - Row R0720: Technical provisions - Index-linked and unit-linked - risk margin

- The following elements of template S.12.01.02:
  - Row R0100: Technical provisions calculated as a sum of BE and RM - Risk margin
  - Rows R0110 to R0130 – Amount of transitional measure on technical provisions

- The following elements of template S.17.01.02:
  - Row R0280: Technical provisions calculated as a sum of BE and RM - Risk margin
  - Rows R0290 to R0310 – Amount of transitional measure on technical provisions

- The following elements of template S.23.01.01
  - Row R0580: SCR
  - Row R0740: Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds

- The following elements of Company template S.28.02.01:
  - Row R0310: SCR

- Elements of the Narrative Disclosures subject to audit identified as 'unaudited'.